Supreme Court, U.S.
FILED

(1) 97.137 JUL 17 1997

OFFICE OF THE CLERK

No. _____

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1996

TOM ANDERSON, *Petitioner,*
v.
COMMISSIONER OF INTERNAL REVENUE, *Respondent,*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Pro Se Petitioner

126 pp

QUESTIONS PRESENTED

(1) The Omnibus Taxpayer Bill of Rights, P.L. 100-647 §6227—Disclosure of Rights of Taxpayers, delegated to the Secretary of the Treasury the preparation a statement which sets forth: the rights of a taxpayer, the obligations of the IRS, and the administrative procedures available to a taxpayer. The question presented is:

WHETHER the Taxpayer has a Sixteenth Amendment Constitutional right or other binding right to have income tax laid in the manner set forth by Congress and its legislative delegate in the Omnibus Taxpayer Bill of Rights; partly superseding *Phillips v. Commissioner*, 283 U.S. 589 (1931).

(2) 26 U.S.C. §6211—Definition of a Deficiency, says that a deficiency is the amount of tax imposed by subtitle A which exceeds the amount of tax shown on a taxpayer's return (plus various adjustments); and a rule for the computation of a deficiency is that the tax imposed by subtitle A and the tax shown on a return shall both be determined (without regard to various payments and credits). 26 U.S.C. §6212—Notice of Deficiency, authorizes the Secretary to issue a notice of deficiency if the Secretary determines that there is a deficiency in respect of tax imposed by subtitle A. 26 U.S.C. §6213—Petition to Tax Court, permits invocation of Tax Court jurisdiction when a §6212 deficiency is mailed. The question presented is:

WHETHER the Commissioner's failure to substantively determine the tax imposed on the Taxpayer by subtitle A; or failure to determine the income received by the Taxpayer in a manner consistent with the Omnibus Taxpayer Bill of Rights and the Secretary's statement, constitutes a failure to determine a statutory deficiency and results in a jurisdictional bar to Tax Court adjudication.

(3) WHETHER the Tax Court exceeded its Article I Constitutional authority in imposing a nonstatutory policy to not look behind a deficiency notice, by suppressing evidence and testimony produced by the Taxpayer: (a) which demonstrates extreme administrative irregularity in the determination of a deficiency, (b) which demonstrates fraud on the Tax Court, and (c) which is relevant to a challenge of Tax Court jurisdiction.

(4) WHETHER the lower courts erroneously disregarded the protection bestowed upon the Taxpayer by: 26 U.S.C. §663 and 26 C.F.R. §1.663(c)—Separate Shares Treated As Separate Trusts; 26 U.S.C. §674 and 26 C.F.R. §1.674—Power to Control Beneficial Enjoyment.

PARTIES

Petitioner-Appellant in this case is Tom Anderson, hereinafter Taxpayer.

Respondent-Appellee in this case is the Commissioner of Internal Revenue, hereinafter Commissioner.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Tom Anderson, Taxpayer, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit, which entered a summary affirmance of a United States Tax Court decision.

OPINIONS BELOW

The opinion of the court of appeals is unreported (App. B, 2a).

The opinions of the Tax Court are reported at T.C. Memo 1992–575 (App. F, 7a-29a) and T.C. Memo 1994–366 (App. H, 31a-38a).

JURISDICTION

The court of appeals entered its judgment on Jan. 21, 1997 (App. B, 2a). The court of appeals entered an order denying petition for rehearing on Apr. 18, 1997 (App. A, 1a). The jurisdiction of this court is invoked under 28 U.S.C. §1254(1). The subject matter jurisdiction of the lower courts has been challenged by the Taxpayer and remains unanswered.

STATUTORY PROVISIONS INVOLVED

Article I of the U.S. Constitution. (App. J, 43a-44a)

Article V amendment to the U.S. Constitution. (App. K, 45a)

Article XVI amendment to the U.S. Constitution. (App. L, 46a)

P.L. 100-647 §6227—Disclosure of Rights of Taxpayers. 102 Stat. 3731. (App. M, 47a)

26 U.S.C. §1(c)—Tax Imposed. (App. R, 66a)

26 U.S.C. §663—Special rules applicable to §§661, 662; Separate Shares Treated As Separate Trusts. (App. S, 67a)

26 C.F.R. §1.663(c)—Separate Shares Treated As Separate Trusts. (App. T, 68a-72a)

26 U.S.C. §674—Power to Control Beneficial Enjoyment. (App. U, 73a-75a)

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26 U.S.C. §6211—Definition of a Deficiency. (App. W, 86a-87a)

26 U.S.C. §6212—Notice of Deficiency. (App. X, 88a-89a)

26 U.S.C. §6213—Restrictions applicable to deficiencies; Petition to Tax Court. (App. Y, 90a-93a)

26 U.S.C. §7441—Status [of Tax Court]. (App. Z, 94a)

26 U.S.C. §7442—Jurisdiction [of Tax Court]. (App. AA, 95a)

STATEMENT

The Commissioner initiated contact with the Taxpayer by issuing a notice of deficiency. It held the Taxpayer liable for 100% of the income earned by a business venture comprised of two trust entities: Para Technologies Trust (Para Tech) in Los Angeles, CA; and Atram Investment Group (Atram) in Turks & Caicos Is. Ownership interest in the venture was held by the Taxpayer: 4%, and by the Taxpayer's Chilean father–in–law: 96%.

The business venture was organized in 1985. The Comissioner began an examination of Para Tech in January, 1990. On 3/19/91, the Commissioner issued deficiency notices to Para Tech, its trustee Fred Ferber, and the Taxpayer. (App. I, 39a-42a). At no time prior to issuing deficiency notices did the Commissioner contact Ferber or the Taxpayer with respect to their individual tax liabilities. On 6/13/91, the Taxpayer and other deficiency recipients petitioned the Tax Court. The three cases were consolidated, and a Tax Court trial was held in March 1993. The Commissioner subsequently conceded the deficiencies against Ferber and Para Tech to be erroneous. The Tax Court decision against the Taxpayer was entered on 4/20/95. (App. E, 5a).

Appeal to the Ninth Circuit was taken on 7/25/95. Taxpayer filed with the Tax Court a motion to vacate for lack of subject matter jurisdiction on 10/10/95, which was returned to the Taxpayer for lack of standing. (App. D, 4a). The Taxpayer filed with the Ninth Circuit Court of Appeals a motion to dismiss for lack of subject matter jurisdiction or remand to determine jurisdiction, which was denied without prejudice on 11/8/95. (App. C, 3a). The Ninth Circuit summarily affirmed the Tax Court decision on 1/21/97 (App. B, 2a), and denied Taxpayer's petition for rehearing on 4/18/97. (App. A, 1a).

The record in the Court of Appeals for the Ninth Circuit differs from the Tax Court record by including: (a) evidence withheld by the Commissioner from formal Tax Court discovery which demonstrates fraud on the Tax Court; (b) evidence withheld by the Commissioner from formal Tax Court discovery which demonstrates a lack of subject matter jurisdiction in the Tax Court; and (c) other evidence demonstrating that the Taxpayer was substantively prejudiced by the Commissioner's failure to respect the Omnibus Taxpayer Bill of Rights, in addition to fraud on the Court and jurisdictional defect.

A. Omnibus Taxpayer Bill of Rights

In this case, the Commissioner did not comply with a single provision set forth in the statement prepared by the Secretary of the Treasury pursuant to P.L. 100-647 §6227(a), 102 Stat. 3731. (App. M, 47a; N, 48a; O, 49a-60a). The lower courts have wholly ignored the Taxpayer's reliance and lengthy briefing on the Taxpayer Bill of Rights and the Secretary's statement. (App. B, 2a; F, 7a-29a).

Prior to issuing the deficiency, the Commissioner did not send any correspondence or otherwise contact the Taxpayer in order to examine and determine the amount of income received by the Taxpayer. The Commissioner knowingly mislead the Tax Court to find that the Taxpayer had been represented by an accountant at an examination, when that power of attorney was actually filed with the Commissioner over 1.5 years after the deficiency was issued.[1] The Commissioner further mislead the Tax Court to find that the Taxpayer examination started in January 1990; when no revenue agent

1. 9th Cir. record at tabs 6, accountant affidavit; 32, Para Tech power of atty.; 57, Taxpayer power of atty.

was assigned,[2] the case was not opened,[3] and the examination return charge out showed no examination time through April 23, 1990.[4]

The Commissioner tried to conceal the failure to examine the Taxpayer by labeling him a "tax protester" and knowingly mislead the Tax Court to find that he refused to cooperate, produce information, or attend examination interviews.[5] The evidence shows that the Commissioner: (a) threatened criminal action and filed a criminal referral against the Taxpayer;[6] (b) exclusively contacted Para Tech agents acting in their official capacities, and never contacted the Taxpayer individually to ask what ownership interest he held in the business venture;[7] and (c) never produced any evidence that any information request was made to the individual Taxpayer which could have been refused. The Commissioner withheld over 275 pages of discoverable documents showing evidence of these and other frauds on the Tax Court. Only 2.5 years after trial could the Taxpayer obtain these documents through a Freedom of Information Act request.[8]

The Commissioner's Ninth Circuit reply brief did not dispute these facts, and all but irrevocably conceded that the Taxpayer was never examined before a deficiency notice was mailed.[9] The failure to examine the Taxpayer substantively prejudiced him with the far more costly and time consuming rigorous evidenciary and procedural requirements of a Tax Court trial.

Beginning on Aug. 8, 1996, the Commissioner announced in IR-96-32 (App. P, 61a) that the statement prepared by the Secretary and delivered to Congress would no longer be distributed as required by P.L. 100-647 §6227(c)—Disclosure Of Rights Of Taxpayers, 102 Stat. 3731. (App. M, 47a). A different document is now distributed which has not been specified by statute and transmitted to Congress. (App. Q, 62a-65a).

The first question involves: (a) the construction and interpretation of P.L. 100-647 §6227(a) Disclosure Of Rights Of Taxpayers; (b)

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2. 9th Cir. record at tab 43; Form 5345, Examination Request Master File.

3. 9th Cir. record at tab 44; AMDIS Transcript, information report.

4. 9th Cir. record at tab 42; Form 5546 Examination Return Charge Out.

5. 9th Cir. record at tabs 6, 39, 44, 45, 46, 50, 52; various reports and records.

6. 9th Cir. record at tabs 44, 46; AMDIS Transcript, Criminal Fraud Referral Declination.

7. 9th Cir. record at tabs 29, 31. Compare Para Tech exam records at tabs 35, 36, 37, 39 with Taxpayer records at tabs 49, 51, 53, 50 respectively.

8. 9th Cir. record at tab 16, FOIA cover letter.

9. 9th Cir. answer brief, p. 34. "Even if taxpayer was not audited through personal interview or correspondence..."

the force and effect of "a statement which sets forth" standards enumerated in the statute and promulgated by the Secretary of the Treasury in accordance with the specific requirements of the statute; and (c) the conflict between the administrative procedures addressed in the statute and *Phillips v. Commissioner*, 283 U.S. 589 (1931), as well as a long string of lower court decisions such as *Luhring v. Glotzbach*, 304 F.2d 560, 564-565 (4th Cir. 1962).

B. Determination of Deficiency

The lower courts have wholly ignored the Taxpayer's jurisdictional challenge that the Commissioner did not make a substantive determination of the Taxpayer's income and tax imposed, and that such failure deprives the Tax Court of subject matter jurisdiction. The only litigation position asserted by the Commissioner appears in her appellate reply brief at pp. 30-31: that the notice itself is what determines whether a deficiency exists. The Commissioner has not produced evidence showing that, prior to issuance of the deficiency notice, a substantive determination was made of the income received and tax imposed upon the Taxpayer, .

At trial the revenue agent for the Commissioner testified that the Commissioner did not know the amount of income received by the Taxpayer, that no distributions of income were found to the Taxpayer,[10] and that the Commissioner set up the tax to the Taxpayer hoping that the true recipients of income would be revealed through litigation.

> "The problem, we don't – we don't know what was the amount either of them had received. ... We would have liked very much to get all of the players who were in the Atram Investment Group in Grand Turk Island, but that information was not given to us. The only persons that we knew were the trustee and Tom Anderson. And that is why we set up the tax to both those parties, hoping that somewhere down the line we would – it would reveal who are the recipients." (RT 254-255)

The Commissioner made no reasonable effort to ascertain the substance of the transactions at issue. The Commissioner had full knowledge of how and where to issue information and document requests, as well as summons, to Atram and the Taxpayer.[11] However,

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10. Tax Court reporters transcript at pp. 258-259 (CR 39, hereinafter RT). Q: Did you find any distributions from Para Tech to Anderson? A: "No. Or any other person."

the Commissioner never requested information and documents from the parties in control and possession of them. Instead, her revenue agent told the Para Tech accountant: that unless Para Tech disclosed the beneficiaries of Atram, criminal action would be filed and deficiencies would be issued to everybody the IRS could find.[12] A criminal referral was filed and later declined,[13] and the deficiencies were issued. The agent's workpapers state that multiple deficiencies were issued to protect the government's interests.[14] The Commissioner's attorney declared the policy in this case by stating to the Para Tech trustee:

> "We're just kind of holding you hostage, but the government has to get its money somewhere." (RT 218).

The second question involves: (a) the construction of statutes defining the determination of a deficiency, authority to issue a deficiency, and invocation of Tax Court jurisdiction; (b) whether the Tax Court is presumed to be without jurisdiction until the existence of a substantive determination of deficiency is shown; and (c) whether the Taxpayer Bill of Rights, P.L. 100-647 §6227(a), in effect construes the statutory term "determine" to include the administrative procedures set forth in the Secretary's statement.

C. Tax Court Authority

The Tax Court suppressed testimony and evidence by invoking a policy to "not look behind a deficiency notice." (RT 310-320). No statute or Tax Court rule exists which supports a policy of disregarding the administrative process of determining a deficiency.

At trial, the Taxpayer attempted to introduce testimony from the revenue agent assigned to examine the Taxpayer. The evidence would have shown significant administrative irregularity in determining the deficiency, and jurisdictional defect. Such suppression occurred in connection with over 275 pages of discoverable evidence improperly withheld by the Commissioner.[15] The Taxpayer was substantively prej-

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11. Atram address was shown on Para Tech K-1 forms filed with the Commissioner, Tax Court Joint Exhibit 1-A, 2-B; Notice of deficiency, Jt. Exh. 8-H, App. I, 39a-42a.

12. 9th Cir. record at tab 6, affidavit from accountant.

13. 9th Cir. record at tabs 44, 46; AMDIS Transcript, Criminal Fraud Referral Declination.

14. 9th Cir. record at tab 39; Form 4318 Examination Workpapers-Para Tech. "Para Tech refused to submit trust documents of Atram used in tax evasion scheme. Therefore, to protect the govt's interest Trust to be taxed - Ferber to be taxed - Anderson to be taxed."

15. 9th Cir. record at tab 16, FOIA cover letter.

udiced in his ability to show: (a) jurisdictional defect; (b) fraud on the court; (c) nonexistent, arbitrary, or capricious determination of a deficiency; or (d) disregard of provisions set forth pursuant to P.L. 100-647 §6227(a)—Disclosure Of Rights Of Taxpayers.

The third question involves: (a) Tax Court practice and procedure; (b) the Article I authority of the Tax Court; and (c) whether the Taxpayer Bill of Rights effectively requires the Tax Court to consider the manner in which a deficiency is determined, when the Taxpayer alleges or shows significant irregularity in the administrative proceedings below.

D. Lower Court Error

The Tax Court held that the Taxpayer was liable for tax on 100% of the income of the Para Tech business venture. The lower courts ignored the protections bestowed upon the Taxpayer by statutes and regulations. 26 U.S.C. §663 and 26 C.F.R. §1.663(c)—Separate Shares Treated As Separate Trusts, require trusts with multiple beneficiaries to be treated as separate trusts. 26 U.S.C. §674 and 26 C.F.R. §1.674—Power to Control Beneficial Enjoyment, grants the Taxpayer the power to temporarily withhold income for later distribution.

The Taxpayer produced disputed evidence that his father-in-law held a 96% ownership interest in the venture. That evidence was authenticated by the Chilean Ministry of Justice, the Chilean Ministry of Foreign Affairs, and the U.S. Embassy Consular in Chile.[16] The Taxpayer further explained to the appearant satisfaction of the Tax Court and the Commissioner during an in camera conference why his father-in-law, a Chilean national, asked to remain anonymous and declined to appear at trial. (RT 96-97).

Although the Taxpayer may have breached the separate status of the business entities (Para Tech is in dispute), the record shows that the total dollar amount of every alleged breach did not exceed his 4% ownership interest in the venture.[17] The Taxpayer also neglected to report and pay tax on his 4% portion of pass-through income constructively received from the venture.

To this day, the Commissioner continues to mislead the courts about business expenses accepted as ordinary and necessary at the Para Tech examination.

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16. Pet. Exh. 419, 420, 421, 422, Res. Exh. PK; CR58.
17. E.g., Jt. Exh. 342-MD - 365-NA; 82-CD.

REASONS FOR GRANTING THE PETITION

The Declaration of Independence addressed the tyranny of imposing taxes on us without our consent. We the people, exercised our right and duty to provide new guards for our future security, and acting through our elected representatives, legislated the Taxpayer Bill of Rights. A bill "that reaffirms our forefathers' belief in the due process rights of every citizen,"[18] making a "major and substantial change in the fundamental relationship between the taxpayer and the tax collector."[19] Congress declared that a taxpayer does have rights and administrative process due, and required them to be set forth and disclosed in a statement by the Secretary of the Treasury Department. That process must achieve an effective and operable result.

This Court is asked to decide whether there must be accountability when IRS employees completely disregard the rights of taxpayers as legislatively set forth by P.L. 100-647 § 6227(a), 102 Stat. 3731. (App. M, 47a; O, 49a-60a). A message is sent to all government employees that disregard of the law is just part of doing a good job when IRS agents and attorneys successfully conspire to disregard the rights of a taxpayer, violate the administrative processes due a taxpayer, cover up their actions by suppressing evidence, and perpetrate fraud upon the courts. Taxpayers fear and distrust the IRS and all branches of government when IRS employees have no deterrent against breaching an act of Congress.

The Commissioner may argue that the negligence of the Taxpayer was so gross that the end justified the means. If we are a government of laws and not of men, then the statutes relied upon by the Taxpayer herein must be regarded with substance and applied without bias, rather than applied in mere form as the Commissioner has argued.

These areas of law desperately need Supreme Court authority in relation to the Taxpayer Bill of Rights, and the statement by the Secretary of the Treasury which sets forth those rights that the Commissioner holds to be without force and effect.

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18. 133 Cong. Rec. S 2562-64, statement of Sen. Pryor (daily ed. Feb. 26, 1987).

19. 134 Cong. Rec. H 9980, statement of Rep. Tallon (daily ed. Oct. 12, 1988); 134 Cong. Rec. H 10119 (daily ed. Oct. 12, 1988).

I. TRIPARTITE CONFLICT—TAXPAYER BILL OF RIGHTS

A conflict exists between the three main branches of government on the issue of taxpayer rights. This is an important federal statutory question involving the construction and application of the Omnibus Taxpayer Bill of Rights. The Commissioner has disregarded and nullified the protection granted taxpayers by Congress under the 16th Amendment to the Constitution. The lower courts have ignored the Taxpayer's reliance on the 16th Amendment and the statute at issue appears to conflict with this Court's decision in *Phillips v. Commissioner,* 283 U.S. 589 (1931). The Commissioner's disregard for the following statute is so complete, that the statement prepared by the Secretary of the Treasury and transmitted to Congress in accordance with subsection (a) and (b) is no longer distributed to taxpayers[20] as required by subsection (c). (App. M, 47a; excerpt follows:)

> P.L. 100-647 §6227. Disclosure Of Rights Of Taxpayers.
> (a) In General.—The Secretary of the Treasury shall, as soon as practicable, but not later than 180 days after the date of enactment of this Act, prepare a statement which sets forth in simple and nontechnical terms—
>
> (1) the rights of a taxpayer and the obligations of the Internal Revenue Service (hereinafter in this section referred to as the "Service") during an audit;
>
> (2) the procedures by which a taxpayer may appeal any adverse decision of the Service (including administrative and judicial appeals);...
>
> (b) Transmission To Committees Of Congress.—The Secretary of the Treasury shall transmit drafts of the statement required under subsection (a)... [to Congress] on the same day.
> (c) Distribution.—The statement prepared in accordance with subsections (a) and (b) shall be distributed by the Secretary of the Treasury to all taxpayers the Secretary contacts with respect to the determination or collection of any tax...

It is the Secretary's statement which sets forth the public rights enumerated by Congress. Congress meant what it said, and said what it meant. The Commissioner and the Court should give effect to the unambiuously expressed intent of Congress and the plain meaning of the statute and the Secretary's statement.[21] Further statutory meaning and construction arguments are well developed but inappropriate

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20. IR-96-32 (App. P, 61a); nondelegated substitute publication (App. Q, 62a-65a).

for this short petition. Legislative history best expresses the very desperate need for this Court to provide guidance on these issues. Statements by the bill's sponsors are supported by passage of the act without a single vote against:

> "We have seen the basic rights of the American taxpayer eroded over the past three decades by court decisions, regulations, and legislation. We think the time is now to restore some of those basic safeguards that the taxpayer deserves. The Taxpayer Bill of Rights will ensure that every American taxpayer knows their rights and also their obligations. This law will protect those rights and will protect the taxpayer from the abuses of sometimes overzealous IRS agents. This law will make a clear statement that those abuses will no longer be tolerated."[22]
>
> "The Taxpayer Bill of Rights is not a simple statement or a meaningless resolution that the taxpayer needs more protection against the abusive methods of the Internal Revenue Service. It is not a simple sense-of-the-Senate resolution. The taxpayer bill of rights, however, is the most comprehensive statutory change in the Internal Revenue Service Code in the last 30 years about what the taxpayer can and cannot do in paying taxes and what the Internal Revenue Service can and cannot do in the collection of those taxes. ... We are today making a major and substantial change in the fundamental relationship between the taxpayer and the tax collector. From the notice of audit and the actual interview between the taxpayer and the agents of the Internal Revenue Service to the final issue of seizure and collection of certain assets, this legislation grants to the American taxpayer certain basic rights."[23]
>
> "We are saying that these rules and regulations can no longer be made just by internal [IRS] changes ... the changes

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21. See e.g. *Freytag v. Commisioner*, 501 U.S. 868, 873 (1991); *Mobil Oil Exploration & Producing Southeast, Inc. v. United Distribution Cos.*, 498 U.S. 211, 223 (1991); *Kosak v. United States*, 465 U.S. 848, 853 (1984); *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982); *Richards v. United States*, 369 U.S. 1, 9 (1962). See also, Singer, *Statutes and Statutory Construction*, §§ 47.33, 57.08, 57.10, 57.12 (5th ed. 1994); Quirk, Greenbaum, Leech, Svartvik, *A Comprehensive Grammar of the English Language*, §§ 6.32, 6.33, 14.4, 17.14, 17.15 (Longman 1985).

22. 134 Cong. Rec. S 15073, statement of Sen. Pryor (Oct. 7, 1988).

23. 134 Cong. Rec. S 15073, statement of Sen. Pryor (Oct. 7, 1988).

> brought about by the taxpayer bill of rights ... can only be made by statute, making this the law of the land."[24]

The Commissioner's applied policy is asserted in her appellate reply brief at pp. 32-33: (a) the statute and the Secretary's statement do not have binding effect, and merely required the description of nonbinding directory guidelines for IRS employees at 26 C.F.R. §601; (b) the statute is a traditional empty standard that merely required preparation and distribution of the Secretary's statement in form; and (c) the issue is governed by the *Phillips* holding that judicial review satisfies all process due the Taxpayer. The Commissioner essentially argues for a construction of 'Disclosure Of Privileges Of Taxpayers' — directory rights, discretionary obligations, and procedures available to the IRS.[25] The Commissioner's construction and application of the statute "Disclosure of Rights of Taxpayers" is diametrically inconsistent with the plain language of the statute (note 21, supra), the purpose of the statute,[26] and the legislative history. The Commissioner argues for a non delegation principle that could nullify the entirety of C.F.R. Title 26.

Three principles give binding effect to the Secretary's statement:

(1) The statement itself is legislation, delegated by Congress under the statute, and reviewed by Congress. The statement legislatively sets forth into law the provisions of the standards enumerated by the statute.

(2) The Statement is a legislative rule, and not just a policy statement or an interpretive rule, because the power to promulgate the required legislation was delegated to the Secretary of the Treasury Department by Congress.

(3) The statement is a regulatory rule, promulgated by the Secretary of the Treasury Department as required by Congress, in the manner prescribed by Congress, and it was reviewed by Congress. It is not a directory rule or internal procedural rule.

The statute is devoid of dilute permissive terminology such as "just and reasonable," "to the maximum extent practicable," "should provide for," or "reasonably appropriate." It is neither a traditional empty standard, a list of unranked decisional goals, nor a list of con-

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24. 134 Cong. Rec. S 17194, statement of Sen. Pryor (Oct. 21, 1988).

25. See, Singer, *Statutes and Statutory Construction*, §47.03 (5th ed. 1994).

26. *New York State Dept. of Social Services v. Dublino*, 413 U.S. 405, 419-420 (1973); *Haggar Co. v. Helvering*, 308 U.S. 389, 394 (1940). See, Singer, *Statutes and Statutory Construction*, §§ 46.05, 46.06 (5th ed. 1994).

tradictory standards. The Secretary's statement itself is not an IRS publication, and it was not promulgated under any code, regulation, or rule. Precedent regarding IRS publications and directory rules promulgated by the Commissioner is inapplicable.

This Court has affirmed broad delegations of power.[27] Congress exercised its constitutional authority and delegated to the Secretary of the Treasury the authority to set forth the meaningful substantive standards enumerated in the statute.[28] Congress did not confer discretion upon the Secretary, but established a mandatory requirement that rights, obligations, and procedures be set forth under the law. The standards provided for in the Secretary's statement reflect a carefully considered decision that Congress made and imposed on the Treasury Department. Congress exercised unusual oversight and left little doubt concerning the actions it expected of the Secretary in exercising the delegated power. Congress resolved a major policy issue and provided reviewing courts with a basis for ensuring that IRS actions are consistent with the legislated policy. The act of Congressional delegation causes the provisions of the Secretary's statement to be binding upon the IRS and courts, whether it is construed as statute, legislative rule, or regulation.[29] In reviewing the Commissioner's applied construction of the statute and provisions delegated thereunder, the second question in *Chevron v. Natural Resources Defense Council*, 467 U.S. 837, 842 (1984) is not reached. Congress spoke directly to the precise question at issue—taxpayer rights—and declared that they exist, shall be set forth by the Secretary, and disclosed to taxpayers.

> "[N]o deference is due to agency interpretations at odds with the plain language of the statute itself. Even contemporaneous and longstanding agency interpretations must fall to the extent they conflict with statutory language."[30]

Nonbinding indication of intended agency policy can be found in the Internal Revenue Manual (excerpt):

> IRM HB 4(10)20.810:(2) "The intent of the Taxpayer Bill of Rights should be the basis for all contact with the public. ...

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27. *Mistretta v. United States*, 488 U.S. 361, 372 (1988); *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 212, 222-223 (1989); *Touby v. United States*, 500 U.S. 160, 165 (1991).

28. U.S. Constitution Art I, sec. 8, cl. 18. See generally, K. Davis, *Administrative Law Treatise*, §§ 2.6, 3.6, 6.3 - 6.5 (3rd ed. 1994).

29. *Batterton v. Francis*, 432 U.S. 416, 425 (1977); *United States v. Nixon*, 418 U.S. 683, 694-696 (1974). Notes 27, 28, supra.

30. *Public Employees Retirement System v. Betts*, 492 U.S. 158, 171 (1989).

> The Taxpayer Bill of Rights should be reviewed often with your group and you should ensure complete compliance with the spirit of the law. An overview of the Taxpayer Bill of Rights as it pertains to the Examination Division is reflected in Publication 1, Your Rights as a Taxpayer."

It is clear and unambiguous that Congress intended and meant for the public rights enumerated in the statute to exist and to be disclosed.[31] A right which is not substantive or binding is no right at all. Congress: (a) established that taxpayer rights, IRS obligations, and administrative procedures exist for a taxpayer; (b) required the Secretary of the Treasury to set forth those standards; and (c) required that those standards be disclosed to a taxpayer. Those standards now constitute the law under which process is due a taxpayer under Article V amendment to the Constitution.

> "[T]axpayers do in fact have certain basic due process rights, and the Internal Revenue Service is going to honor those rights."[32]

Administrative process allows the IRS to apply its specialized expertise, correct its own mistakes, minimize judicial intervention, and conserve judicial resources. Historic lack of administrative process requirements has encouraged IRS employees to deliberately bypass administrative procedures when it serves their immediate interests.[33]

The Secretary's statement provides that the tax appeal process starts with an examination by correspondence or interview. The Secretary could have declared that the tax appeal process can start with a notice of deficiency, but clearly indicated two distinct starting points in simple and nontechnical terms. Even a child can understand what "start here" means, as shown in the statement. (App. O, 53a). After starting the process, various choices are available to a taxpayer. The statement sets forth the right that:

> "You can appeal the findings of an examination within the IRS through our appeals office. Most differences can be settled

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31. See, Singer, *Statutes and Statutory Construction*, §47.21 (5th ed. 1994).

32. 134 Cong. Rec. H 9980, statement of Rep. Tallon (daily ed. Oct. 12, 1988); 134 Cong. Rec. H 10119 (daily ed. Oct. 12, 1988).

33. 133 Cong. Rec. S 2563, statement of Sen. Pryor (daily ed. Feb. 26, 1987); Senate Finance Subcommittee on Oversight of the Internal Revenue Service hearings on S. 579 and S. 604 the, 100th Cong., 1st. Ses., pt. 1, at 142, 228, noted by Senator Armstrong.

> within this appeals system without expensive and time consuming court trials." (App. O, 54a).

The stage in the process at which a notice of deficiency is issued follows those procedures "by which a taxpayer may administratively appeal any adverse decision," as legislatively granted by Congress.

In this case, the tax appeal process did not start with an examination, and the Taxpayer was afforded no administrative process of any kind whatsoever. The Taxpayer was denied the right to appeal the findings of an examination through the IRS appeals office. The Commissioner even refused to reply to three written requests by the Taxpayer for a pretrial administrative appeals conference.[34]

The touchstone of due process is protection of the individual against arbitrary action of government.[35] The imbalance is clear in this case: the private interest at stake, times the risk of erroneous deprivation, is infinitely greater than the impact and cost of the procedures already available to all other taxpayers.[36] At $425,000, the private interest at stake in this case was substantial. The risk of erroneous deprivation was greatly increased when the Taxpayer was denied all administrative process by the agency with particular expertise in determining tax liability. This prejudiced the Taxpayer with the significant costs, years of effort, rigorous procedures and formal evidenciary requirements of Tax Court litigation that gave him no second chance to interactively show that he did not earn the income at issue. There is no added cost or adverse impact to the government. The Commissioner has frequently stated that the provisions of the Omnibus Taxpayer Bill of Rights: "...are long-standing tenets of our tax administration system that are available to all taxpayers."[37]

> [T]he taxpayer bill of rights will not hamper, it will not impede, it will not damage, it will not handcuff the Internal Revenue Service... it will enable those safeguards, those basic safeguards, to go to the taxpayer rather than extra rights and extra powers to the Internal Revenue Service.[38]

Once an agency adopts a set of procedures by rule, due process requires the agency to comply with its own procedural rules even if

34. 9th Cir. record at tab 58, 59, 60.

35. *Wolff v. McDonnell*, 418 U.S. 539, 558 (1974).

36. *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976).

37. IR-88-150 (referring to the Secretary's Statement republished in IRS publ. 1). See also, T.D. 3616; 67 J. TAXN. 266 (1987); TAX NOTES, Mar. 2, 1987, at 853.

38. 134 Cong. Rec. S 17194, statement of Senator Pryor (daily ed. Oct. 21, 1988).

the procedures adopted by the agency exceed those independently required by due process.[39]

This Court has not directly visited this issue since *Phillips* in 1931. Major taxpayer rights legislation has dramatically changed that landscape in recent years. The Commissioner does not regard the statute as binding, and relies squarely on *Phillips* as decisive precedent. Only this Court can determine the impact of the Taxpayer Bill of Rights on *Phillips*; and the appropriate deterrant to infringement of the taxpayer rights, IRS obligations, and process due under the law.

To deter future infringement of the 16th Amendment priveleges granted taxpayers by Congress, this Court is asked to consider that: (a) when rights to administrative process are infringed completely, a statutory deficiency is not determined, and the Tax Court lacks subject matter jurisdiction; (b) when rights to administrative process are infringed in part, the burden of production and persuasion is shifted to the Commissioner; (c) when rights to administrative process are infringed in one instance, the burden of persuation is shifted to the Commissioner.

A severe imbalance exists between the reliance of taxpayers on the public rights promised in the Secretary's statement, and judicial precedent governing its force and effect. The law is in a state of confusion with no precedent controlling the construction or application of this significant federal legislation. The Taxpayer has found only one minor reference to the Secretary's statement in any court opinion.[40] The Commissioner's existing policy is that the statute, upon which millions of taxpayers rely each year, is without force or effect. This case exemplifies the problems Congress sought to correct and prevent with enactment of P.L. 100-647 §6227—Disclosure Of Rights Of Taxpayers.

II. IMPORTANCE

A decision in this case will have pervasive effect. In 1995 alone, 154.3 million tax returns were filed and over 2.1 million returns were examined. The amount in controversy was $27.8 billion.[41] The Taxpayer Bill of Rights requires that each examined taxpayer receive the

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39. See, *United States v. Nixon*, 418 U.S. 683, 694-696 (1974). Citing; *Vitarelli v. Seaton*, 359 U.S. 535, 539 (1959); *Service v. Dulles*, 354 U.S. 363, (1957); *United States ex rel. Accardi v. Shaughnessy*, 347 U.S. 260, 267 (1954).

40. *United States v. Lehigh*, 102 F. Supp. 224, 225 (W.D. AR 1991).

41. *1995 IRS Annual Data Book*, Publ. 55B, table 11

Secretary's statement. The resolution of these questions will have immidiate importance far beyond the particular facts and parties involved in this case. This controversy presents a real and intolerable conflict between a law enacted by Congress, prior precedent of this Court, and the applied policy of the Commissioner. This issue is not merely academic or episodic, but of concern to 114.7 million individual taxpayers. The issues in this case are of actual substantive importance for 1.9 million individual taxpayers examined and the $7.8 billion in controversy every year. (id.)

From a perspective closer to you the reader, the statistical probability from the IRS data indicates that at least 5 Supreme Court employees are examined each year, and 1 Supreme Court Justice will be examined in the next 8 years. The average amount of additional tax and penalties recommended is $6,547.37 for individuals with income over $50,000. (id.). When (and if) the Secretary's statement is given to these probable examinees, how will they know if they actually have the rights stated, or if the form is merely government doublespeak and they do not really have all the rights promised?

This case presents substantial questions of public rights, due process granted by Congress, statutory construction of determining tax, and Tax Court jurisdiction. The plans, hopes, and aspirations of millions of taxpayers each year are effected by the uncertainty of their relations, rights, and process due with the Commissioner. Patience in judicial resolution will not resolve these issues, but will subject more taxpayers to treatment contrary to the Secretary's statement, and will allow the Commissioner to further disregard statutes granting rights and process to taxpayers.

III. Federal Statutory Issue

The law is in a state of confusion, and there is inconsistent application of statute with respect to the determination of a federal tax deficiency. No statutory definition of the term "determine" exists. 26 U.S.C. §6211 merely states that the tax imposed by subtitle A and the tax shown on a return shall both be determined. The statutory root of "determine" is "discover."[42]

26 U.S.C. §6212 states: "If the Secretary determines that there is a deficiency...he is authorized to send notice..." The Commissioner's policy argued in this case is that the statutory determination require-

42. Revenue Act of 1921, Ch. 136, §250(d), 42 Stat. 265.

ment is in form only, and a deficiency notice is self determining. Thus, the statute also means: "If the Secretary is determined that there is as deficiency..."

Some circuits have held that the determination requirement has substantive content, requiring the Commissioner to thoughtfully consider information that relates to a taxpayer before it can be found that the Commissioner determined a deficiency.[43] Other circuits hold that the notice itself constitutes the determination necessary to convey jurisdiction upon the Tax Court.[44] The Tax Court holds that a determination must be thoughtful and considered,[45] while stating that there is no requirement that a notice of deficiency have a reasonable basis in both fact and law.[46]

To compound the confusion further, P.L. 100-647 §6227(a) required the Secretary of the Treasury to set forth the administrative procedures available to a taxpayer, in contrast to the discretionary procedures available to IRS agents. This raises the question of what administrative process is due under that law, before a statutory deficiency can be determined. No court has addressed the relation of the Secretary's statement to the form v. substance determination issue, and the decision in *Phillips*.

The Commissioner's revenue agent in this case testified that prior to issuing the deficiency notice, the income received by the Taxpayer was not known and no income distributions to him were found. (RT 254-255, 258-259). This raised a question of subject matter jurisdiction: (a) the Taxpayer's income was not known; (b) a deficiency was not determined in accordance with 26 U.S.C. §6211—Definition of a Deficiency, because 26 U.S.C. §1(c)—Tax Imposed, does not impose a tax for amounts of income unknown; (c) the Commissioner lacked authority to issue a deficiency notice under 26 U.S.C. §6212—Notice of Deficiency, because a deficiency could not have been determined under the definition of 26 U.S.C. §6211; and (d) the Tax Court could not acquire jurisdiction under 26 U.S.C. §6213—Petition to Tax Court. Instead of fulfilling the duty to ascertain the substance of the

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43. See e.g., *Scar v. Commissioner*, 814 F.2d 1363, 1368 (9th Cir. 1987); *Pierce v. Commissioner*, 946 F.2d 1543 (5th Cir. 1990).

44. *Rosenberg v. Commissioner*, 450 F.2d 529, 533 (10th Cir. 1971); *Benzvi v. Commissioner*, 787 F.2d 1541, 1542 (11th Cir.), cert. denied, 479 U.S. 883 (1986); *Estate of Yaeger v. Commissioner*, 889 F.2d 29, 34 (2nd Cir.1989), cert. denied, 495 U.S. 946 (1990).

45. Couzens v. Commissioner, 11 B.T.A. 1040, 1159-1160 (1928).

46. Powers v. Commissioner, 100 T.C. 475, 34 (1993).

transactions,[47] the Commissioner chose to hide behind the burden of proof and issued multiple deficiency notices to protect the government's interests, and coerce information from the Taxpayer.[48] A suspicion that the government's interests need protecting is not a determination of tax imposed on the Taxpayer.

The lower courts have ignored the Taxpayer's jurisdictional challenge. The reluctance of a federal court to address a jurisdictional challenge based on revenue agent testimony, the substance of a federal statute, and prominent legislation setting forth taxpayer rights is a troubling problem of federal court jurisdiction, practice, and prodedure. As stated in *Kokkonen v. Guardian Life Ins. Co.*, 511 U.S. 375, 377 (1994):

> "Federal courts are courts of limited jurisdiction. They possess only that power authorized by Constitution and statute, see *Willy v. Coastal Corp.*, 503 U.S. 131, 135 (1992); *Bender v. Williamsport Area School Dist.*, 475 U.S. 534, 541 (1986), which is not to be expanded by judicial decree, *American Fire & Casualty Co. v. Finn*, 341 U.S. 6 (1951). It is to be presumed that a cause lies outside this limited jurisdiction, *Turner v. President of Bank of North-America*, 4 Dall. 8, 11 (1799), and the burden of establishing the contrary rests upon the party asserting jurisdiction, *McNutt v. General Motors Acceptance Corp.*, 298 U.S. 178, 182-183 (1936)."

The Commissioner contends that premise is defeated by *Welch v. Helvering*, 290 U.S. 111, 115 (1933), which holds that the Commissioner's determination is presumed correct. However, something that does not exist can never be presumed correct. This Court previously indicated that the Commissioner is not entitled to a presumption of correctness when there is irregularity in the administrative proceedings or insufficient legal evidence.[49] An administrative decision cannot be presumed correct, when that presumption requires the disregard of subject matter jurisdiction and 16th Amendment protection.

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47. *Lucas v. Earl*, 281 U.S. 111, 114-115 (1930); *Gregory v. Helvering*, 293 U.S. 465, 467-470 (1935); *Corliss v. Bowers*, 281 U.S. 376, 378 (1930).

48. 9th Cir. record at tab 39; Form 4318 Examination Workpapers-Para Tech. "Para Tech refused to submit trust documents of Atram used in tax evasion scheme. Therefore, to protect the govt's interest Trust to be taxed - Ferber to be taxed - Anderson to be taxed."

49. *Phillips v. Commissioner*, 283 U.S. 589, 600 (1931).

The Commissioner has never established that the income received by the Taxpayer was substantively determined prior to issuing the deficiency notice, or that the administrative procedures set forth in the Secretary's statement were respected. As stated in *Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534, 547 (1986):

> "[B]ecause it is not 'sufficient that jurisdiction may be inferred argumentatively from averments in the pleadings,' *Grace v. American Central Ins. Co.*, 109 U.S. 278, 284 (1883); *Thomas v. Board of Trustees*, 195 U.S. 207, 210 (1904), it follows that the necessary factual predicate may not be gleaned from the briefs and arguments themselves. This 'first principle of federal jurisdiction' applies 'whether the case is at the trial stage or the appellate stage.' P. Bator, P. Mistakin, D. Shapiro, & H. Wechsler, Hart and Wechsler's *The Federal Courts and the Federal System* 835-836 (2d ed.1973)."

Over 114 million individual taxpayers need a consistent and uniform rule on this issue to secure equal treatment by the IRS in all federal jurisdictions, and to secure their relations with the government.

IV. Supervisory Power—Article I Authority

The United States Tax Court is an Article I court, and its authority is strictly limited by statute.[50] It is the determination of a deficiency which conveys jurisdiction upon the Tax Court. The Tax Court maintains a policy to "not look behind a deficiency notice."[51] No statute or Tax Court rule of practice and procedure exists which supports the policy of disregarding the administrative process of determining a deficiency.

Judicial expediency in a trial de novo initially accords the Commissioner's determination a presumption of correctness. However, the Tax Court's policy conflicts with this Court's statement that legal insufficiency and irregularity in administrative proceedings were issues available to reasonably dispute a presumption of correctness.[52] The policy prevents taxpayers from raising the issues and demonstrating the abuses which Congress sought to correct and prevent with the

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50. 26 U.S.C. § 7441; 26 U.S.C. §7442; *Freytag v. Commissioner*, 501 U.S. 868, 890-891 (1991); *Commissioner, v. Gooch Mining & Elevator Co.*, 320 U.S. 418, 422 (1943).

51. *Scar v. Commissioner*, 81 T.C. 855, 861 (1983). See, *Riland v. Commissioner*, 79 T.C. 185, 201 (1982); *Greenberg's Express, Inc. v. Commissioner*, 62 T.C. 324, 327 (1974).

52. *Phillips v. Commissioner*, 283 U.S. 583, 600 (1931).

Taxpayer Bill of Rights. The policy also precludes a taxpayer from raising jurisdictional questions and showing fraud on the court.

In this case, the Tax Court enforced its policy and suppressed evidence. (RT 310-320). The Tax Court lacked Article I authority to prevent the Taxpayer from reasonably disputing a presumption of correctness by showing: (a) jurisdictional defect; (b) fraud on the court; (c) significant irregularity in administrative proceedings; or (d) disregard of provisions set forth pursuant to P.L. 100-647 §6227(a)—Disclosure Of Rights Of Taxpayers.

The exercise of supervisory powers by this Court will greatly clarify the important, complex, and unprecedented relationships between the jurisdictional issues addressed herein, the Article I limits of Tax Court practice and procedure, and the provisions set forth by P.L. 100-647 §6227(a)—Disclosure Of Rights Of Taxpayers.

V. Supervisory Power—Error of Law

The primary holding of the Tax Court in this case pertains to distributable net income of the business venture. 26 C.F.R. §1.663(c)–1(a)—Separate Shares Treated As Separate Trusts, specifically provides that:

> "Application of this rule will be significant in, for example, situations in which income is accumulated for beneficiary A [Taxpayer's father-in-law] but a distribution is made to beneficiary B [Taxpayer] of both income and corpus in an amount exceeding the share of income that would be distributable to B [Taxpayer] had there been separate trusts. In the absence of a separate trust rule, B [Taxpayer] would be taxed on income which is accumulated for A [Taxpayer's father-in-law]. The division of distributable net income into separate shares will limit the tax liability of B [Taxpayer]."

Rather than recognizing the protections granted by this binding rule, the Tax Court found that the conditions described in the regulation resulted in a 100% liability to the Taxpayer on income accumulated for his father-in-law. The rule clearly states its significance for the Taxpayer's situation, and unambiguously states that the Taxpayer's liability is limited by the rule.

26 U.S.C. §674(b)(6)—Power To Control Beneficial Enjoyment, Exception For Power To Withhold Income Temporarily, exempts the Taxpayer from being treated as the owner of the 96% portion of

income controlled and held for his father-in-law. The Tax Court essentially found that the exercise of unrestrained power to control beneficial enjoyment constituted a sham arrangement. The statute and regulations make an exception for any person, where the Tax Court did not.

Internal Revenue Bulletin 1997-16 and related policy information notifies taxpayers that the Commissioner has adopted a policy to disregard more trust arrangements than in the past. This interpretive change increases the uncertainty in the relationship between taxpayers and the government. Precedent by this Court on the application of these statutes will provide critical guidance for 3.1 million fiduciary returns filed each year.[53]

VI. Supervisory Power—Error of Fact

The Taxpayer offers just one of many examples why the lower court was unjustified in finding that Para Tech was a sham, and that the Taxpayer was liable for $425,000 of tax on the Commissioner's evidence purportedly showing less than $10,000 of income actually received. To this day, the Commissioner continues to misrepresent the facts of this case before the courts. The Commissioner argues that the Taxpayer had two personal telephone numbers, while Para Tech had no telephone number. This is a bizzare distortion of the evidence which shows that: (a) Para Tech conducted active business transactions exceeding $100,000 annually, and must have used the telephone; (b) the Para Tech phone number was printed on the face of the checks that paid its phone bills;[54] (c) the Para Tech phone number was different than the Taxpayer's residential phone number;[55] (d) not even one Para Tech check matched any phone bill for the Taxpayer's residence;[56] and (e) the revenue agent examining Para Tech accepted all expense deductions as ordinary and necessary, including the deductions for the phone bills later alleged to be income received by the Taxpayer and alleged to constitute a badge of sham.[57]

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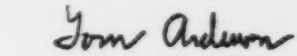
53. *1995 IRS Annual Data Book*, Publ. 55B, table 11.
54. E.g., Jt. Exh. 91-CM; Para Tech phone number was 213-458-4153.
55. Jt. Exh. 322-LJ; Taxpayer residential phone number was 213-458-9983.
56. Various from Jt. Exh. 91-CM to 189-GG; 323-LK to 336-NB
57. Para Tech deficiency notice at Jt. Exh. 7-G.

CONCLUSION

For the foregoing reasons, this petition should be granted and a writ of certiorari should be issued to review the decision below.

Respectfully submitted,



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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT
(Filed Apr 18 1997)

TOM ANDERSON, Petitioner-Appellant,	)	No. 95-70588
v.	)	ORDER
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.	)	

Before: ALDISERT*, PREGERSON and THOMAS, Circuit Judges.

Appellant's petition for rehearing is denied.

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* Honorable Rugerro J. Aldisert, Senior United States Circuit Judge for the Third Circuit, sitting by designation.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT
(Filed Jan 21 1997)

TOM ANDERSON, Petitioner-Appellant,	)	Case No. 95-70588
v.	)	Tax Ct. No. 12242-91
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.	)	ORDER*

Appeal from the decision of the United States Tax Court
Judge Julian I. Jacobs, Presiding
Submitted January 10, 1997**
Portland, Oregon

Before: ALDISERT***, PREGERSON and THOMAS, Circuit Judges.

Affirmed for the reasons stated in the well-reasoned opinion of the United States Tax Court dated August 2, 1994.

AFFIRMED

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* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by Ninth Circuit Rule 36-3.

** The panel unanimously finds this case suitable for submission on the record and briefs and without oral argument. Fed. R. App. 34(a) and Ninth Circuit Rule R. 34-4.

*** Rugerro J. Aldisert, Senior United States Circuit Judge for the Third Circuit, sitting by designation.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT
(Filed Nov 08 1995)

TOM ANDERSON, Petitioner-Appellant,	)	Case No. 95-70588
v.	)	IRS# 12242-91
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.	)	ORDER

Before: Peter L. Shaw, Appellate Commissioner

Appellant's "Motion to Dismiss for Lack of Subject Matter Jurisdiction" appears to be a motion for summary reversal or vacation of the Tax Court's decision based on the contention that the Tax Court lacked jurisdiction. So construed, the motion is denied without prejudice to appellant raising the issue in the briefs. Appellant's "Motion to suspend" is likewise denied without prejudice to appellant raising the jurisdictional issue in the briefs.

Appellant's opening brief is due November 17, 1995; appellee's brief is due December 18, 1995; the optional reply brief is due 14 days after the service of appellee's brief.

[Signature]
General Order 6.3(e)

commpanel/nov95/sh/2

APPENDIX D

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

Dkt. No.12242-91

The enclosed documents Motion to Vacate and Exhibits received Oct 10, 1995 are returned *unfiled* for the following reasons:

Because case is now on appeal to the United States Court of Appeals for the Ninth Circuit, this cannot now be considered by the Tax Court. The Tax Court cannot act with regard to this case unless so directed by the Court of Appeals.

Office of the Clerk
Oct 13 1995
Returned to Tom Anderson

Form 133

APPENDIX E

UNITED STATES TAX COURT

TOM ANDERSON, Petitioner,	)	
v.	)	Docket No. 12242-91
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to the opinion of the court (T.C. Memo. 1994-366) filed August 2, 1994, and incorporating herein the facts recited in the Respondent's computation as the findings of the Court, it is:

ORDERED AND DECIDED: that there is a deficiency in income tax due from the Petitioner for the taxable year 1987, in the amount of $94,056.00;

that there is no addition to tax due from the Petitioner for the taxable year 1987 under Internal Revenue Code Section 6653(b)(1)(A);

that there is no addition to tax due from the Petitioner for the taxable year 1987 under Internal Revenue Code Section 6653(b)(1)(B);

that there is an addition to tax due from the Petitioner for the taxable year 1987 under Internal Revenue Code Section 6653(a)(1)(A), in the amount of $4702.80;

that there is an addition to tax due from the Petitioner for the taxable year 1987 under Internal Revenue Code Section 6653(a)(1)(B), in the amount equal to 50 percent of the interest due on the deficiency of $94,056.00;

that there is an addition to tax due from the Petitioner for the taxable year 1987 under Internal Revenue Code Section 6661(a), in the amount of $23,514.00;

that there is a deficiency in income tax due from the Petitioner for the taxable year 1988, in the amount of $70,464.00;

that there is no addition to tax due from the Petitioner for the tax-

able year 1988 under Internal Revenue Code Section 6653(b)(1);

that there is an addition to tax due from the Petitioner for the taxable year 1988 under Internal Revenue Code Section 6653(a)(1), in the amount of $3,523.20; and

that there is an addition to tax due from the Petitioner for the taxable year 1988 under Internal Revenue Code Section 6661(a), in the amount of $17,616.00;

Entered: Apr 20 1995

(signed) Julian I. Jacobs
Judge

APPENDIX F

T.C. Memo 1994-366

UNITED STATES TAX COURT

PARA TECHNOLOGIES TRUST, Petitioner v.

COMMISSIONER OF INTERNAL REVENUE, Respondent;

TOM ANDERSON, Petitioner v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PARA TECH TRUST v. COMMISSIONER OF INTERNAL REVENUE

Docket Nos. 12089-91, 12242-91

Filed August 2, 1994

Decision will be entered for petitioner in docket No. 12089-91.
Decision will be entered under Rule 155 in docket No. 12242-91.

For petitioners: Joe Alfred Izen, Jr., n1 Helena C. Papadopoulos, and Michael Louis Minns.

n1 Joe Alfred Izen, Jr., withdrew as petitioners' counsel following an Order of the Court, dated Sept. 28, 1992, granting respondent's Motions to Compel Withdrawal of Petitioners' Counsel of Record for Conflict of Interest. Para Technologies Trust v. Commissioner, T.C. Memo. 1992-575. Mr. Izen did, however, assist and consult with petitioners' counsel during the course of trial of these consolidated cases.

For respondent: Paul B. Burns and Maria D. Murphy.

[*2]

MEMORANDUM FINDINGS OF FACT AND OPINION

JACOBS, Judge: Respondent determined the following deficiencies in, and additions to, petitioners' Federal income tax:

Para Technologies Trust:

Year	Deficiency	Additions to Tax Sec. 6653(b)	Sec. 6661
1987	$103,450	n1 $77,588	$25,862
1988	74,253	55,690	18,563

n1 Plus 50 percent of the interest due on the deficiency.

Tom Anderson:

Year	Deficiency	Additions to Tax Sec. 6653(a)	Sec. 6653(b)	Sec. 6661
1987	$109,755	n1 $5,488	n1 $82,316	$27,439
1988	71,720	3,586	53,790	17,930

n1 Plus 50 percent of the interest due on the deficiency.

All section references are to the Internal Revenue Code in effect for the years in issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

On brief, respondent concedes that no deficiencies in income tax, or additions to tax, are due from Para Technologies Trust (Para Tech). After this and other concessions, the issues remaining for decision are: (1) Whether Para Tech should be respected as a distinct taxable entity for Federal income tax purposes, and if it is to be so respected, then (2) whether the income received by Para Tech is taxable to Tom Anderson (Anderson) under the grantor trust provisions of sections 671 through 679; (3) whether Anderson is liable for additions to tax for fraud pursuant to section 6653(b); or, alternatively, whether he is liable for additions to tax for negligence pursuant to section 6653(a); and (4) whether Anderson is liable for additions to tax for substantial understatement of income tax pursuant to section 6661.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

The stipulation of facts and attached exhibits are incorporated herein by this reference.

Para Tech had its principal place [*3] of business in California, and Anderson resided in Santa Monica, California, at the time they filed their petitions.

I. Nassau Life Insurance Co., Ltd. and Joe Alfred Izen, Jr.

Nassau Life Insurance Co., Ltd. (Nassau Life) promoted the use of domestic and foreign entities to shelter U.S. business and investment income from Federal income taxation. Nassau Life engaged in this activity through representatives known as information officers and through the dissemination of printed materials. Joe Alfred Izen, Jr. (Izen) was counsel to Nassau Life during both years in issue. In the course of that representation, among other services, he prepared and issued two opinion letters that related to the multiple-entity tax shelter promoted by Nassau Life.

In an opinion letter dated September 26, 1983 (1983 opinion letter), Izen discussed the legal status of contractual trust companies that were being promoted by Nassau Life, and concluded that they were valid legal entities. In an opinion letter dated June 20, 1985 (1985 opinion letter), Izen discussed the tax aspects of these contractual trust companies, and concluded that the grantor trust provisions of the Internal Revenue Code [*4] (Code) did not apply to contractual trust companies. However, neither of Izen's opinion letters discussed cases decided contrary to the positions he was espousing.

II. Tom Anderson and Frederick Ferber

Anderson dropped out of school after completing the eighth grade. Since age 14, Anderson has been a video engineer. A video engineer designs, operates, and repairs electronic equipment. At the time of trial, Anderson was 31 years old. Beginning in late 1982, and continuing until January 10, 1985, Anderson operated a sole proprietorship under the name "Videolab", which manufactured, sold, modified, and repaired electronic equipment. On February 8, 1984, Anderson filed a fictitious business name statement with the County Clerk of Los Angeles County, California, showing his use of the name "Videolab".

Anderson and Frederick Ferber (Ferber) met in India in 1977 and began a long-lasting friendship. Ferber is a songwriter with a high

school education. Ferber has no significant training or experience in electrical engineering or electronics. Ferber is 6 years older than Anderson. In 1984, Anderson told Ferber that he was interested in developing technology with people from [*5] foreign countries. Anderson said that he wanted to form a legal entity that would permit a foreign investor to assist him in developing technology while minimizing his accounting and tax burdens.

At that time, Ferber was employed as an information officer for Nassau Life. Ferber described to Anderson the supposed advantages of the specific trust structure that was being promoted by Nassau Life. He explained that, according to Nassau Life, this structure had the potential of reducing U.S. Federal income taxation or deferring taxation until distributions were made to beneficial interest certificate holders, and that Nassau Life had been promoting this structure since 1978. Ferber made copies of Nassau Life's written promotional materials describing its trust structure, and provided these copies to Anderson. In describing Nassau Life's trust structure to Anderson, Ferber relied at least partially on Izen's 1983 opinion letter. Ferber subsequently provided access to that letter to Anderson. Anderson then visited Nassau Life's office in Inglewood, California, to further inquire about this structure.

III. Para Tech

Relying in part on Ferber's advice and in part on the opinions [*6] expressed in Izen's 1983 opinion letter, Anderson decided to implement the trust structure being promoted by Nassau Life. On January 10, 1985, Chris M. Riley (Riley), as creator, Sarah Martel (Martel), as exchanger, and Ferber, as trustee, executed a document captioned "Contract" (Para Tech agreement), pursuant to which Para Tech was formed as a common law business trust. n2

----------Footnotes----------

n2 A business trust is an unincorporated business organization created by an instrument by which property is held and managed by trustees for the benefit and profit of such persons as may be or become the holders of transferable certificates evidencing the beneficial interests in the trust estate. 156 A.L.R. 27 (1945).

----------End Footnotes----------

At the time of Para Tech's formation, Riley and Martel were associated with Scientific Asset Management, the U.S. agent for Nassau Life in Nassau Life's efforts to promote its trust structure. At the time

of Para Tech's formation, Riley appointed Ferber as Para Tech's trustee. Ferber never owned a [*7] beneficial interest in Para Tech, and Ferber never received compensation or other economic benefit as a result of serving as Para Tech's trustee.

On January 10, 1985, the date of Para Tech's formation, Ferber appointed Anderson as Para Tech's president and Kevin Irelan (Irelan) as Para Tech's secretary, and delegated to the president or secretary the power "to operate the Company affairs and business matters on behalf of the Certificate holders and Trustee of the Company". The power delegated to them was limited to "the execution of business and routine day-to-day matters not requiring a Trustee Minute".

At the time of Para Tech's formation, Martel exchanged $100 for a certificate evidencing her ownership of 100 capital units of Para Tech, which constituted all of the beneficial interest in Para Tech. Para Tech was authorized to distribute all income annually to its certificate holder. Anderson then executed a document pursuant to which he provided $100 cash plus assignments on a nonexclusive basis of certain intangible personal property to Para Tech in exchange for a certificate representing Martel's 100 capital units of Para Tech. The intangible personal property that Anderson [*8] assigned to Para Tech included: (a) Items collectively described as "First Generation Time Code Retrofit Technology" (first generation technology); (b) items collectively described as "Second Generation Time Code Retrofit Technology" (second generation technology); and (c) items collectively described as "Type 6 Time Code Retrofit Technology" (type 6 technology).

In late January or early February 1985, Anderson filed a certificate of abandonment of the fictitious business name "Videolab" with the County Clerk of Los Angeles County, California. Immediately after Anderson abandoned the fictitious business name "Videolab", Para Tech filed a fictitious business name statement with the County Clerk of Los Angeles County, California, indicating that Para Tech was using the fictitious business name "Videolab" in its business. Thereafter, Para Tech conducted business activities that were virtually identical to those previously conducted by Anderson in his sole proprietorship.

IV. Atram Trust

At the same time that Para Tech was formed, Atram Trust (Atram) was formed. Walter R. Simons, of the Turks and Caicos Islands, British

West Indies, as creator, Cynthia A. Francis (Francis), [*9] also of the Turks and Caicos Islands, as exchanger, and Nassau Life, as trustee, executed a document captioned "Contract" (Atram agreement), pursuant to which Atram was formed as a common law business trust. Veronica D. Williams (Williams) signed the Atram agreement on behalf of Nassau Life. Francis was employed by or associated with Nassau Life. Anderson has never met Walter Simons, Francis, or Williams, nor has Anderson ever visited the Turks and Caicos Islands. The Para Tech agreement and the Atram agreement are identical in every material respect, except for the identity of the parties, the situs of the trusts created, and the choice of law provisions.

On January 10, 1985, the day of Para Tech's and Atram's formation, Nassau Life appointed Anderson as Atram's president/agent, and delegated to him the power "to operate the Company affairs and business matters on behalf of the Certificate Holders and Trustee". The power delegated to Anderson was limited to "the execution of business and routine day-to-day matters not requiring a Trustee Minute". The written instrument, captioned "Minutes of Atram Investment Group", pursuant to which Anderson was appointed as Atram's president, [*10] was signed on behalf of Nassau Life by Robert Chappell (Chappell). Anderson has never met Chappell.

At the time of Atram's formation, Francis exchanged $100 for a certificate evidencing her ownership of 100 capital units of Atram, which constituted all of the beneficial interest in Atram. Anderson then executed a document pursuant to which he assigned certain intangible personal property on a nonexclusive basis to Atram in exchange for a certificate representing 99 of Francis' capital units of Atram. The intangible personal property that Anderson assigned to Atram included: (a) First generation technology; (b) second generation technology; (c) type 6 technology; and (d) items collectively described as "Computer Aided Design System Plan" (CAD plan). The first generation technology, second generation technology, and type 6 technology that Anderson assigned to Atram are identical to the first generation technology, second generation technology, and type 6 technology that Anderson had previously assigned to Para Tech.

After January 10, 1985, neither Walter Simons nor Francis had further involvement with Atram, except that Francis continued to hold one capital unit of Atram. Francis [*11] never received any distributions with respect to the capital unit of Atram that she retained.

V. Para Tech's and Atram's Business Agreements With Anderson,

With Each Other, and With Mr. Smith

On January 17, 1985, Atram provided certain unspecified items of property to Para Tech, "as defined by separate contract", in exchange for Anderson's certificate representing 100 capital units of Para Tech. The intangible personal property that Atram assigned to Para Tech pursuant to this agreement included: (a) First generation technology; (b) second generation technology; and (c) type 6 technology. The first generation technology, second generation technology, and type 6 technology that Atram assigned to Para Tech are identical to the first generation technology, second generation technology, and type 6 technology that Anderson had previously assigned to both Para Tech and Atram. Because Atram was now Para Tech's sole certificate holder, Atram held the entire beneficial interest in Para Tech. Para Tech was authorized to distribute all income annually to its certificate holder. The certificate holder did not have the power to hire or fire Para Tech agents or employees, to change [*12] the terms of the trust agreement, or to vote or participate in the management of company affairs. The written instrument, captioned "Minutes of Atram Investment Group", pursuant to which the transfer was authorized, was signed on behalf of Nassau Life by Delphine Simons, whom Anderson has never met.

The second generation technology consists of a unique magnetic head design, a unique circuit board design, and unique designs of key items. On August 8, 1985, Anderson determined that he was unable to provide the second generation technology to Atram. Accordingly, on that date, Atram released Anderson from his obligation to provide the second generation technology, type 6 technology, and CAD plan to Atram, in exchange for Anderson's surrender of 95 of the 99 capital units of Atram that he held.

After Anderson tendered the 95 capital units back to Atram, Atram purportedly became involved with an unidentified Chilean national who was referred to at trial as "Mr. Smith" (Smith). n3 Smith allegedly is a professor of mathematics. He has no background or experience in electrical engineering or electronics. By a written instrument dated August 15, 1985, Smith allegedly entered into an [*13] agreement pursuant to which he assigned certain intangible personal property to Atram in exchange for the 95 capital units of Atram that Anderson had previously tendered back to Atram. The intangible personal property that Smith allegedly assigned to Atram included the second generation technology, type 6 technology, and

CAD plan. This arrangement gave Smith 95 percent of Atram, Anderson 4 percent, and Francis 1 percent. The trustee kept sole discretion as to whether distribution should be made to the beneficiaries; the beneficiaries had no right to compel distribution of any of the trust assets.

----------Footnotes----------

n3 Smith did not testify, nor did he appear, at trial.

----------End Footnotes----------

The second generation technology and type 6 technology that Smith allegedly assigned to Atram are identical to the second generation technology and type 6 technology that Anderson had assigned to both Atram and Para Tech, that Atram had assigned to Para Tech, and that Atram had released Anderson from his obligation to provide. The CAD plan that Smith allegedly assigned [*14] to Atram is identical to the CAD plan that Anderson had previously assigned to Atram, and that Atram had released Anderson from his obligation to provide.

As the second generation technology was perfected over the next several years, Atram assigned that technology to Para Tech. As a result, Para Tech's sales greatly improved. Atram also provided ongoing support for the technology that it had assigned to Para Tech. In return, over the years, Para Tech transferred substantial sums of money to Atram.

VI. Anderson's, Para Tech's, and Atram's Financial Dealings

From some time prior to December 1984, until December 1985, Anderson maintained a checking account with First Interstate Bank. Anderson closed this account on December 16, 1985. During the years in issue, Anderson did not maintain a personal checking account at any financial institution.

On February 5, 1985, and October 8, 1987, Para Tech opened two checking accounts in the name of "Videolab/ Para Tech Technologies Trust" (Videolab account 1 and Videolab account 2, respectively) at City National Bank. Anderson, Ferber, and Irelan were authorized to withdraw or disburse funds from these two accounts.

In February [*15] 1985, Atram opened a checking account in the name of "Atram Investment Group" (Atram account 1) at First Interstate Bank. On January 25, 1988, and October 7, 1988, Atram opened two checking accounts in the name of "Atram Investment Group" (Atram account 2 and Atram account 3, respectively) at City National Bank. At the time of the opening of Atram account 2 and Atram

account 3, Anderson was requested to furnish Atram's tax identification number to City National Bank. Both times, he gave City National Bank the tax identification number assigned to Nassau Life. The record does not indicate what tax identification number was given to First Interstate Bank at the time of the opening of Atram account 1. Anderson and Irelan were authorized to withdraw or disburse funds from the three Atram accounts.

During 1985, 12 checks payable to Atram, in the aggregate amount of $62,000, were drawn on Videolab account 1. During 1986, nine checks payable to Atram, in the aggregate amount of $55,400, were drawn on Videolab account 1. During 1987, Para Tech transferred, by various means, a total of $209,710 to Atram. During 1988, Para Tech transferred, by various means, a total of $261,175 [*16] to Atram.

On several different occasions during 1985, Anderson sold tools and hardware to Para Tech. The items that Anderson sold to Para Tech are items that Anderson had previously used in his sole proprietorship. After Para Tech purchased these items, Para Tech used them in its business. On February 15, 1985, Anderson, as Para Tech's agent, issued a payment to Scientific Asset Management for services rendered in connection with Para Tech's formation.

At all times relevant to this case, Anderson resided in an apartment located at 1208 Broadway in Santa Monica, California. In October 1985, Videolab moved its principal place of business from Anderson's apartment in Santa Monica, California, to 1978B Del Amo Boulevard in Torrance, California. On several different occasions during the years in issue, Anderson's apartment rent was paid by checks drawn on Videolab account 1 or Atram account 3. On several different occasions during the years in issue, the telephone and utility bills for this address, as well as Anderson's medical expenses, were paid by checks drawn on Videolab account 1. In addition, during 1985 and 1986, Anderson cashed several checks that were drawn on Videolab [*17] account 1. When Anderson traveled for Para Tech, he frequently bought groceries, instead of eating at restaurants, and paid for these groceries with Para Tech funds drawn on Videolab account 1.

By a written instrument captioned "Minutes of Atram Investment Group" dated November 12, 1985, Nassau Life, as Atram's trustee, authorized Atram to purchase an automobile for an amount not to exceed $15,000, and authorized Atram's president (i.e., Anderson) to use Atram's automobile. The minutes were signed on behalf of Nas-

sau Life by Delphine Simons. Anderson subsequently sold his 1979 Volkswagen Super Beetle to Atram for $600. After he sold his automobile to Atram, Anderson continued to use it for personal purposes. Anderson was not required to pay Atram for the personal use of the automobile. On three occasions between November 30, 1988, and September 15, 1989, checks payable to the order of Walt's Auto, in the aggregate amount of $830, were drawn on Atram account 3. Other checks drawn on Atram account 3 included checks payable to a retail record store, an outdoor equipment retailer, and a gourmet food and wine shop.

On several occasions during 1989, checks payable to the order [*18] of Patricia Prado (Prado) were drawn on Atram account 3, in the aggregate amount of $11,670. Prado is Smith's daughter. During the years in issue, Prado had no relationship to Atram or Para Tech, but she was romantically involved with Anderson, whom she had met through Smith. At the time of trial, Prado was married to Anderson, and Smith was identified as Anderson's father-in-law. The funds paid to Prado from Atram account 3 were to defray her living expenses. She was not required to perform, and did not perform, any services for Para Tech or Atram in return for those payments. In fact, Prado had an "immigration problem" and was not permitted to work in the United States at the time.

By a written instrument captioned "Minutes of Atram Investment Group" dated August 9, 1985, Nassau Life, as Atram's trustee, authorized the granting of a $75,000 "personal line of credit" to Anderson by Atram. Anderson could draw on the line of credit by causing Atram's president (i.e., Anderson) to issue financial instruments to any person. The minutes were signed on behalf of Nassau Life by Delphine Simons.

By a written instrument captioned "Minutes of Atram Investment Group" dated May 4, [*19] 1990, Nassau Life, as Atram's trustee, authorized Atram to lend up to $250,000 to Para Tech on or after January 1, 1991. The minutes further provided that Atram's president (i.e., Anderson) would administer the loan from Atram to Para Tech. The minutes were signed on behalf of Nassau Life by Delphine Simons.

By a written instrument captioned "Minutes of Atram Investment Group" dated August 12, 1991, Nassau Life, as Atram's trustee, authorized Atram to purchase Para Tech's "inventory, equipment, and physical assets". None of the terms of the purchase are set forth in the minutes. The minutes further stated that Atram's president (i.e.,

Anderson) would administer the purchase. The minutes were signed on behalf of Nassau Life by Delphine Simons.

VII. Atram's Winding Up

By a written instrument captioned "Minutes of Atram Investment Group" dated November 9, 1992, which by its terms reflects actions taken at a meeting held in Sullivan County, New York, on that date, Nassau Life, as Atram's trustee, authorized Atram's exercise of the option previously granted by Francis to Atram to purchase back for $10 the one capital unit of Atram held by her. Atram had no such option [*20] with respect to Anderson's or Smith's certificates. The minutes were signed by Anderson, by Irelan, and on behalf of Nassau Life by Delphine Simons. Anderson has not visited Sullivan County, New York, since 1988.

By a written instrument captioned "Minutes of Atram Investment Group" dated November 9, 1992, which by its terms reflects actions taken at a meeting held in Sullivan County, New York, on that date, Nassau Life, as Atram's trustee, authorized Atram's winding up and the distribution of its assets to the holders of the capital units. The minutes were signed by Anderson, by Irelan, and on behalf of Nassau Life by Delphine Simons. At the time of trial, Nassau Life was bankrupt.

VIII. Para Tech's and Anderson's Tax Returns

On the Para Tech 1987 and 1988 U.S. Fiduciary Income Tax Returns (Para Tech 1987 return and Para Tech 1988 return, respectively), Para Tech claimed deductions in the amounts of $209,710 and $261,175, respectively, for amounts distributed to Atram as Para Tech's beneficiary. On Schedules K-1 attached to the Para Tech 1987 return and the Para Tech 1988 return, Para Tech characterized the amounts distributed to Atram during those taxable years as [*21] consisting entirely of dividend income. On Schedules K-1 attached to the Para Tech 1987 return and the Para Tech 1988 return, Para Tech identified Atram using the tax identification number assigned to Nassau Life. Nassau Life, as trustee of Atram, directed Anderson, the president/agent of Atram, to give Nassau Life's tax identification number to Para Tech for use in identifying Atram on returns to be filed by Para Tech. Atram has never requested nor been assigned a tax identification number.

Para Tech did not file any Internal Revenue Service Forms 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, or any Internal Revenue Service Forms 1042S, Foreign Person's U.S. Source Income Subject to Withholding, for any taxable period that included any part of the calendar years 1987 or 1988. During 1987, Para Tech gave Internal Revenue Service Forms 1099-MISC, Miscellaneous Income, to persons other than employees who performed services for Para Tech, and filed those forms with the Internal Revenue Service. Atram never filed any Federal income tax returns or information returns for any taxable period that includes any part of the calendar years 1987 or 1988. [*22]

Anderson timely filed U.S. Individual Income Tax Returns for 1987 and 1988 (Anderson 1987 return and Anderson 1988 return, respectively). On the Anderson 1987 return, Anderson reported total income of $4,102, consisting of $3,900 of dividend income and $202 of income from an unincorporated video engineering business. On the Anderson 1988 return, Anderson reported total income of $4,878, consisting of $4,650 of dividend income and $228 of income from the unincorporated video engineering business. For both years, he did not report any salary or wage income and did not report any income attributable to the rent-free use of the automobile that was provided to him by Atram. Because Anderson reported more than $400 of dividend income for each year, he was required to complete part III (consisting of lines 10 and 11) of Schedules B attached to the Anderson 1987 return and the Anderson 1988 return. Line 11 of Schedules B asks the question "Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it?" and requires the taxpayer to check either a box labeled "yes" or a box labeled "no". [*23] On line 11 of Schedules B attached to the Anderson 1987 return and the Anderson 1988 return, Anderson checked the box labeled "no". Anderson has never filed Internal Revenue Service Form 3520, Creation of or Transfers to Certain Foreign Trusts, or Internal Revenue Service Form 3520-A, Annual Return of Foreign Trust with U.S. Beneficiaries.

In preparing the Para Tech 1987 return, the Para Tech 1988 return, the Anderson 1987 return, and the Anderson 1988 return, Anderson relied in part on Izen's 1985 opinion letter, which states that the grantor trust provisions of the Code do not apply to contractual trust companies. He also relied on instructions given to him by Ferber, the trustee of Para Tech. Ferber, in turn, relied on Izen's 1985

opinion letter as well as on advice given to him by an accountant associated with Nassau Life. Anderson did not consult with an attorney or an accountant in order to determine whether it was proper for Para Tech to file Forms 1041, U.S. Fiduciary Income Tax Returns, which it filed for taxable years 1987 and 1988.

IX. Respondent's Examination of Para Tech's and Anderson's Tax Returns

Lawrence G. Camporeale (Camporeale) was the internal revenue [*24] agent assigned to examine the Federal income tax liabilities of Anderson and Para Tech for the taxable years in issue. On February 6, 1990, Camporeale met with Anderson at Para Tech's place of business. During the course of that meeting, Camporeale asked Anderson to provide identification. Anderson showed Camporeale his driver's license and gave Camporeale a Social Security number. The Social Security number that Anderson gave to Camporeale is not Anderson's correct Social Security number.

On February 22, 1990, Camporeale mailed a letter to Anderson scheduling a conference for March 1, 1990, and encouraging Anderson to provide certain documents. Anderson did not appear on March 1, 1990, and did not contact Camporeale prior to that date to reschedule the conference.

In February 1990, Ferber, as trustee of Para Tech, directed Anderson, the president of Para Tech, to hire William Leon Meeks (Meeks), a certified public accountant, to represent Para Tech. Anderson and Para Tech then engaged Meeks to represent them in connection with the examination. Meeks had not previously represented Anderson, Para Tech, or Ferber in any capacity. On February 27, 1990, Camporeale received a [*25] letter from Meeks stating that he had a power of attorney authorizing him to represent Para Tech with respect to its 1987 tax year.

On February 28, 1990, Camporeale mailed a letter to Meeks asking for copies of substantially the same documents he had requested from Anderson. Meeks advised Anderson and Ferber that they were obligated to provide all information and documents requested by respondent. Anderson refused to make available to Meeks any documents relating to Atram. Meeks turned over all documents that he received from Anderson or Ferber to Camporeale. On March 19, 1990, Camporeale received the following documents from Meeks: (a) A copy of the Para Tech agreement; (b) copies of statements for

Videolab account 1 for the period December 29, 1986, through December 29, 1987; and (c) copies of statements for Videolab account 2 for the period October 8, 1987, through December 8, 1987.

Camporeale and Meeks met at Camporeale's office on May 11, 1990. At that meeting, Camporeale served a Form 4564, Information Request, which had been prepared by respondent's international examiner, Dennis Bracken, on Meeks. Dennis Bracken served another Form 4564 on Meeks on June 29, 1990. [*26] Very little of the information requested in the Forms 4564 was ever provided.

On March 19, 1991, respondent timely mailed a notice of deficiency, determining deficiencies in income tax and additions to tax for the taxable years 1987 and 1988, to Anderson at his last known address by certified mail. On December 9, 1992, respondent mailed a Branerton letter to Anderson. On December 22, 1992, respondent prepared and signed Respondent's First Set of Interrogatories to Petitioner (interrogatories) and Respondent's First Request for Production of Documents (document request), and caused them to be served on Anderson. Responses to the interrogatories were required to be served on or before February 5, 1993. Documents were required to be produced at respondent's counsel's office on February 5, 1993. Among the documents that Anderson was requested to produce were all documents relating to Para Tech's and Atram's bank accounts. Anderson did not appear at respondent's counsel's office on February 5, 1993, to make any documents available for inspection or copying as provided in the document request. Anderson did not provide written responses to the interrogatories or the document request [*27] on or before February 5, 1993.

On February 8, 1993, respondent filed Motions to Compel Responses to the Interrogatories and the Document Request. On February 9, 1993, this Court entered an order in docket No. 12242-91 granting the motions to compel. On February 10, 1993, respondent received responses to the interrogatories. On February 23, 1993, respondent received supplemental responses to the interrogatories. On February 25, 1993, petitioners made approximately 2,500 pages of documents available for inspection and copying. The bulk of the documents that were made available were copies of canceled checks and deposit receipts for 1985 and 1986 for Videolab account 1. No documents relating to Atram account 1 were ever produced.

On January 19, 1993, Anderson sent letters to City National Bank and First Interstate Bank in a purported attempt to obtain copies of documents relating to Para Tech's and Atram's accounts with those

banks. In those letters, Anderson states the following:

I find it necessary to personally request copies of certain bank records for accounts which are not mine. I do not have an account at any branch of * * * [your institution]. This request is [*28] made personally and is not made as an Agent of Atram Investment Group. I am not presently authorized as an Agent of Atram Investment Group to make such a request. In a letter dated February 22, 1993, City National Bank refused to make the requested records available to Anderson, because "City National Bank cannot produce records to other than its customer without its customer's consent".

On March 16, 1993, petitioners notified respondent that Anderson, in his capacity as president/agent of Atram, had arranged for certain documents to be produced at the U.S. Embassy in Santiago, Chile, that day. They had been requested initially by respondent in the document request. They were made available to respondent on the day before the trial of this case, with the exception of one document, which was made available to respondent on the second day of the trial.

OPINION

Issues 1 and 2. Para Tech's Officers and Trustee Disregarded Para Tech's Form to Such an Extent That Para Tech Will Be Disregarded as a Separate Entity

Anderson contends that Para Tech was a valid entity, legally independent and separate from Anderson as an individual, and that Para Tech and the transactions [*29] in which it took part should be respected for Federal tax purposes. Respondent contends that Para Tech is a sham, that the transactions in which Para Tech purported to engage were totally without economic substance, and that Para Tech existed for no purpose aside from being used in a scheme to obtain tax benefits at no economic cost to Anderson. Respondent contends, in the alternative, that if we conclude that Para Tech is a valid trust entity for tax purposes, then Anderson is taxable on the income reported as earned by Para Tech under the grantor trust provisions of sections 671 through 679. We believe that Para Tech and Atram are merely paper entities, devoid of economic substance and formed by Anderson solely as a scheme to avoid taxation on the income from

Videolab's business. Accordingly, we hold that the trust structures of these entities should not be respected for Federal income tax purposes, and that the income from Para Tech is taxable wholly to Ander-

son. We reach the latter conclusion because we are not entirely convinced that there was any meaningful economic relationship between Smith and Para Tech. However, assuming arguendo that Smith had an economic relationship [*30] with Para Tech, based on the record herein, we are unable to determine how much of Para Tech's income is attributable to Smith's services or contribution. In the absence of evidence linking a specified portion of Para Tech's income to Smith, all of such income must be attributed to Anderson. Due to the aforementioned holdings, we need not deal with respondent's alternative contention.

It is well settled that taxpayers have the right to conduct their transactions in such a manner and form as to minimize or altogether avoid the incidence of taxation by whatever means the law permits. *Gregory v. Helvering*, 293 U.S. 465, 469 (1935). The Government, however, is not required to apply the tax laws in accordance with the form employed by the taxpayer where that form is a sham or is inconsistent with economic reality. *Higgins v. Smith*, 308 U.S. 473, 477 (1940). Application of these principles requires us to look beneath the surface of the entities and transactions at issue to examine their reality. *Professional Servs. v. Commissioner*, 79 T.C. 888, 924 (1982). When the form of the transaction [*31] has not, in fact, altered any cognizable economic relationships, that form will be ignored and the law will be applied according to the substance of the transaction. *Markosian v. Commissioner*, 73 T.C. 1235 (1980). These principles apply even though an entity or entities may have been properly formed and have a separate existence under applicable local law. *Zmuda v. Commissioner*, 79 T.C. 714, 720 (1982), affd. 731 F.2d 1417 (9th Cir. 1984).

The present case involves a common law business trust, commonly known as a Massachusetts trust. A Massachusetts trust is:

> a form of business organization consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit of such persons as may from time to time be holders of transferable certificates issued by the trustees showing the shares into which the beneficial interest is divided, which certificates entitle the holders to share ratably in the income of the property, and, on termination of the trust, in the proceeds thereof * * *. [12A [*32] C.J.S., Business Trusts, sec. 2 (1980); fn. refs. omitted.]

In general, California law recognizes the validity of Massachusetts trusts. See *Goldwater v. Oltman*, 210 Cal. 408, 292 P. 624 (1930). However, in *Goldwater* the California Supreme Court held that in order to

validly form a business trust, the settlors must transfer the legal title to property "to trustees, with complete power of management in such trustees free from the control of the creators of the trust". Id. at 416, 292 P. at 627.

In the present case, immediately after Para Tech was formed, the trustee (i.e., Ferber) delegated virtually complete control over its business and assets back to the settlor (i.e., Anderson). After that delegation of authority, Ferber ceased to play any meaningful role in the management of Para Tech. Thus, an essential requirement for the formation of a business trust, the separation of legal title from the settlor's control, was missing.

With respect to Atram, the record is devoid of any evidence that the requirements of Turks and Caicos Islands law were observed in connection with its [*33] formation. In fact, the record is devoid of any evidence of what those requirements are. The question of compliance with Turks and Caicos Islands law was squarely placed in issue by respondent in her answer in this case. Anderson has the burden of proof with respect to this issue. He cannot rest solely on the denial of respondent's allegation; he must come forward with evidence. He has not done so. Therefore, we must conclude that Atram is a legal nullity, which can have no significance for tax purposes.

Most of the parties to the Para Tech agreement and the Atram agreement, and the persons who signed the minutes authorizing actions by Para Tech and Atram, are persons who were essentially unknown to Anderson. Riley, Martel, Walter Simons, Delphine Simons, Francis, and Chappell each came on the scene for a brief moment, signed a few documents, and disappeared. None of them ever played any meaningful role in the affairs of Para Tech or Atram. The use of strangers as signers of organizational documents, and the failure of the nominal trustees of trusts to have any meaningful role in the operation of those trusts, have been repeatedly cited by this Court as evidence that the [*34] entities formed pursuant to those documents lack economic substance. See, e.g.,

Paulson v. Commissioner, T.C. Memo. 1991-643, affd. without published opinion 994 F.2d 843 (8th Cir. 1993); *Zmuda v. Commissioner*, supra at 720-721; *Akland v. Commissioner*, T.C. Memo. 1983-249, affd. 767 F.2d 618 (9th Cir. 1985).

The manner in which the organization of the entities was accomplished lends additional support to the conclusion that they were mere paper constructs, which should be ignored for tax purposes. After Para Tech and Atram were formed, there was no meaningful

change in the manner in which the Videolab business was operated. Immediately after Para Tech's formation, Ferber appointed Anderson as Para Tech's president and delegated virtually complete control over Para Tech's affairs to him. Immediately after Atram's formation, Nassau Life, as nominal trustee of Atram (which owned Para Tech), appointed Anderson as Atram's president/agent, with similarly broad authority. This abdication of responsibility by trustees, resulting in effective [*35] control of the trust by the settlor, demonstrates that the formation of the trust lacks economic substance. See *Paulson v. Commissioner*, supra; *Vercio v. Commissioner*, 73 T.C. 1246, 1250-1251 (1980).

Anderson surrendered the use of the fictitious business name "Videolab", which was immediately assumed by Para Tech. All of the tangible and intangible assets that Anderson had previously used in his sole proprietorship were transferred to Para Tech and were used by Para Tech in the same business activity. Anderson worked extremely long hours in the business, while Ferber, the nominal trustee, had virtually no involvement in the business. Anderson continued to make all important business decisions – what products would be manufactured and sold, what prices would be charged, what employees would be hired or fired – with little or no input from anyone else. In short, after Para Tech and Atram were formed, Anderson "conducted * * * [his] business and lived * * * [his] private * * * [life] exactly the same as before the trust was created." Markosian v. Commissioner, supra at 1243. [*36]

The flow of economic benefits among Para Tech, Atram, and Anderson is a variation on the so-called circular flow common to numerous tax evasion schemes involving the use of foreign trusts. Anderson performed services for Para Tech, for which he was not compensated. Para Tech earned income from the sale of products designed and manufactured by Anderson. Para Tech made trust distributions to Atram. Atram extended a line of credit to Anderson, which he was responsible for administering.

Because Anderson had signature authority on all of Para Tech's and Atram's bank accounts, he could effectively disburse money to himself at any time. He could, and did, use Para Tech's and Atram's funds to pay his personal and living expenses. In fact, Anderson was so sure that he could use Para Tech and Atram to pay his personal and living expenses that he closed all of his own bank accounts.

Para Tech and Atram paid Anderson's rent, utility bills, and medical expenses. For a time, Atram supported Anderson's girlfriend.

Atram provided Anderson with the rent-free use of a car, the same car that Anderson had previously sold to Atram, and Atram paid to maintain that car.

The record includes checks [*37] drawn on Atram account 3 that appear to represent payment of personal and living expenses of Anderson. Those checks include checks payable to a retail record store, an outdoor equipment retailer, and a gourmet food and wine shop. At trial, Anderson testified to purported business purposes for those expenses. This was not corroborated by any other witness or by any documentary evidence. We are not bound to accept, and do not accept, Anderson's self-serving testimony. *Tokarski v. Commissioner*, 87 T.C. 74, 77 (1986); *Wichita Terminal Elevator Co. v. Commissioner*, 6 T.C. 1158 (1946), affd. 162 F.2d 513 (10th Cir. 1947).

It is clear that at all times relevant to this case, Anderson treated the Para Tech and Atram accounts as though they were his personal accounts. The circular flow has consistently been regarded by this Court as compelling evidence that arrangements involving multiple trusts lack economic substance. See, e.g., *Professional Servs. v. Commissioner*, 79 T.C. at 928; *Tatum v. Commissioner*, T.C. Memo. 1990-119; *Akland v. Commissioner*, supra. [*38]

Finally, neither Anderson, Para Tech, nor Atram filed all the necessary Federal tax returns, or included the required information on the returns that they did file. As noted above, if Anderson had actually transferred assets to Atram, he should have answered "yes" on line 11 of Schedules B attached to his returns. He should also have filed Form 3520. He did neither.

During 1987 and 1988, Para Tech reported that it distributed U.S. source dividend income to Atram. Para Tech did not withhold tax and file Forms 1042 and 1042S as is required by section 1441 and section 1.1461-2, Income Tax Regs. The amount of the purported dividends was more than $600 in both 1987 and 1988. Therefore, Atram should have filed Forms 1040NR for 1987 and 1988 reporting that income, and should have paid taxes on it. See sec. 6012(a)(4); see also sec. 1.6012-3(a)(1)(ii), Income Tax Regs. It did not file any returns, and there is no evidence that it paid any tax.

In both 1987 and 1988, Para Tech earned U.S. source interest income. It purportedly distributed that interest income to Atram. If so, it should have withheld tax and filed Forms 1042 and 1042S. It did not. Failure to file returns that [*39] are consistent with the purported economic substance of the entities and the transactions is further evidence that the substance does not exist.

During the years in issue in this case, Atram did not have a tax identification number that uniquely identified it, despite the fact that it should have obtained one and furnished it to Para Tech for inclusion in Para Tech's Schedules K-1. See sec. 6109(a); sec. 301.6109-1(b), (d)(2), Proced. & Admin. Regs. Instead, Atram was identified using a number that had been assigned to Nassau Life. This is further evidence that Anderson did not treat Atram as an economically viable and separate entity.

As we said in *Markosian v. Commissioner*, 73 T.C. at 1245: "Since petitioners did not respect this trust as a separate entity, we can see no reason to do so". Likewise, we herein hold that Para Tech should be disregarded as a separate entity for Federal income tax purposes and all of its income should be attributable to Anderson.

Issue 3. Anderson Is Not Liable for Additions to Tax for Fraud

Respondent bears the burden of proving fraud by clear and convincing evidence. Sec. 7454(a); Rule 142(b). For taxable [*40] year 1987, section 6653(b)(1)(A) and (B) provides that if any portion of a deficiency in income tax is due to fraud, additions to tax are imposed in amounts equal to 75 percent of the portion of the underpayment which is attributable to fraud and 50 percent of the interest due on the portion of the underpayment which is attributable to fraud. For taxable year 1988, section 6653(b)(1) provides that if any portion of a deficiency in income tax is due to fraud, an addition to tax is imposed in an amount equal to 75 percent of the underpayment (excluding any portion of the underpayment which the taxpayer establishes is not attributable to fraud).

To prevail, respondent must prove by clear and convincing evidence that some part of the underpayment of tax was due to fraud. Sec. 7454(a); Rule 142(b). To do so, respondent must establish that Anderson intended to evade taxes believed to be owing, by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes. *Stoltzfus v. United States*, 398 F.2d 1002, 1004 (3d Cir. 1968); *Webb v. Commissioner*, 394 F.2d 366 (5th Cir. 1968), affg. T.C. Memo. 1966-81. [*41]

The existence of fraud is a question of fact to be resolved upon consideration of the entire record. *Rowlee v. Commissioner*, 80 T.C. 1111, 1123 (1983); *Gajewski v. Commissioner*, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). Fraud will never be presumed. *Beaver v. Commissioner*, 55 T.C. 85, 92 (1970).

Fraud may, however, be proved by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. *Stephenson v. Commissioner*, 79 T.C. 995, 1005-1006 (1982), affd. 748 F.2d 331 (6th Cir. 1984); *Gajewski v. Commissioner*, supra at 200. The taxpayer's entire course of conduct may establish the requisite fraudulent intent. *Spies v. United States*, 317 U.S. 492 (1943); *Gajewski v. Commissioner*, supra at 200; *Stone v. Commissioner*, 56 T.C. 213, 223-224 (1971).

Although there are several factors or "badges" existing [*42] in this case which might indicate fraud, on balance, we believe that respondent has not proven fraud by clear and convincing evidence. Anderson was not familiar with complex financial structures. He never attended high school, ceasing his formal education with the completion of eighth grade. Anderson's lack of financial sophistication is reflected in his testimony that he was uncertain as to the nature of his obligations. Anderson relied heavily on Izen and Nassau Life. Thus, we find respondent has not proven by clear and convincing evidence that Anderson understood that he carried out his dealings in such a way as to not respect the financial structures involved. Accordingly, we do not sustain respondent's determination with regard to the additions to tax for fraud under section 6653(b).

Issue 4. Anderson Is Liable for Additions to Tax for Negligence

As an alternative to her determination of fraud, respondent determined that the entire amount of the deficiencies determined against Anderson for both taxable years in issue in this case was due to negligence or intentional disregard of rules and regulations.

For taxable year 1987, section 6653(a)(1)(A) and (B) provides [*43] that if any portion of a deficiency in income tax was due to negligence, additions to tax are imposed in amounts equal to 5 percent of the underpayment and 50 percent of the interest due on the portion of the underpayment which is attributable to negligence. For the taxable year 1988, section 6653(a)(1) provides that if any portion of a deficiency in income tax was due to negligence, an addition to tax is imposed in an amount equal to 5 percent of the underpayment.

For purposes of section 6653(a), negligence is defined as the lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances. *Neely v. Commissioner*, 85 T.C. 934, 947 (1985). The burden of proof is on the taxpayer to show that he acted prudently and exercised due care. *Bixby v. Commissioner*, 58 T.C. 757, 791-792 (1972).

We are not convinced that Anderson acted prudently and exercised due care. An ordinarily prudent person would not enter into a complicated business trust arrangement based solely on the representations by the organization promoting that trust and its counsel. Further, an ordinarily prudent [*44] person, even one of modest education, would not have believed that the deposit of business receipts into an account that he totally controlled was a proper method of relieving those receipts from tax. Accordingly, we find that Anderson has failed to carry his burden of proof on this issue and thus sustain respondent's alternative negligence determination.

Issue 5. Anderson Is Liable for Additions to Tax for Substantial Understatement

Section 6661 provides for an addition to tax equal to 25 percent of the amount of any underpayment attributable to a substantial understatement of income tax. Under section 6661(b)(1)(A), a substantial understatement is defined for individual taxpayers as the greater of $5,000 or 10 percent of the tax required to be shown on the return. The amount of the understatement is reduced by the portion of the understatement attributable to the tax treatment of any item if there was adequate disclosure of the relevant facts affecting treatment of the item in the return or a statement attached to it, or if there is or was substantial authority for the treatment. Sec. 6661(b)(2)(B).

There is substantial authority for the treatment of an item only [*45] if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary positions. Sec. 1.6661-3(b)(1), Income Tax Regs. A taxpayer's belief that there is substantial authority for the tax treatment of an item is irrelevant to this determination. Id. For this purpose, "authority" includes the Code, the regulations, revenue rulings, revenue procedures, administrative pronouncements, tax treaties and regulations thereunder, legislative history materials, and case law. Sec. 1.6661-3(b)(2), Income Tax Regs. Conclusions reached in treatises and legal periodicals, and opinions rendered by tax professionals, are not authority. Id. Hence, Izen's opinion letters do not constitute substantial authority for Anderson's actions.

Accordingly, the amount of the deficiency in Anderson's Federal income taxes for 1987 and 1988 meets the definition of a substantial understatement for this purpose. Anderson did not have substantial authority for his position in any year in issue. Likewise, he did not

adequately disclose any facts pertaining to the understated income on any of the tax returns as filed, or on any statements attached [*46] to such returns. Accordingly, we sustain respondent's determination with respect to Anderson's liability for the additions to tax under section 6661.

To reflect the foregoing and concessions by respondent,
Decision will be entered for petitioner in docket No. 12089-91.
Decision will be entered under Rule 155 in docket No. 12242-91.

APPENDIX G

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

PARA TECHNOLOGIES TRUST, ET AL., Petitioners,	)	
v.	)	Docket Nos. 12089-91, 12242-91
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	12445-91

ORDER

On January 3, 1992, respondent's Motions to Compel Withdrawal of Petitioner's Counsel of Record for Conflict of Interest was filed in docket Nos. 12089-91 and 12242-91. On January 3, 1992, respondent's Motions to Compel Withdrawal of Petitioner's Counsel of Record for Conflict of Interest was filed in docket No. 12445-91. Pursuant to the determination of the Court as set forth in its Memorandum Opinion (T.C. Memo. 1992-575), filed September 28, 1992, it is hereby

ORDERED: That respondent's above-referenced motions are granted and Joe Alfred Izen, Jr., is withdrawn as petitioners' counsel in these cases.

Mary Ann Cohen
Judge

Dated: Washington, D.C.
September 28, 1992

APPENDIX H

T.C. Memo 1992-575

UNITED STATES TAX COURT

PARA TECHNOLOGIES TRUST, ET AL., n1 Petitioners v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PARA TECH TRUST v. COMMISSIONER

Docket Nos. 12089-91, 12242-91, 12445-91
Filed September 28, 1992 [*1]

Respondent's motions will be granted.

For Petitioners: Joe Alfred Izen, Jr.
For Respondent: Paul B. Burns.

n1 Cases of the following petitioners are consolidated herewith: Tom Anderson, docket No. 12242-91; and Fred Ferber aka Frederick Ferber, docket No. 12445-91.

MEMORANDUM OPINION

COHEN, Judge: Each of these cases is before the Court for ruling on respondent's Motion to Compel Withdrawal of Petitioners' Counsel of Record for Conflict of Interest. The issue for decision is whether a conflict of interest exists that requires the disqualification of petitioners' counsel of record. Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years at issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Petitioners Para Technologies Trust (Para Tech) and Tom Anderson (Anderson) had their principal places of business in California at the time they filed their petitions. Petitioner Fred Ferber aka Freder-

ick Ferber (Ferber) resided in California at the time he filed his petition. (Anderson resided in Oregon at the time of hearing on the pending motions in March 1992, but the record is silent with respect to his residence at the time he filed his petition.)

Background

Nassau Life Insurance Company, Ltd. (Nassau Life), promoted the use of domestic [*2] and foreign entities to shelter United States business and investment income from United States Federal income taxation. Nassau Life engaged in this activity through representatives known as "information officers" and through the dissemination of printed materials. From 1982 through 1988, Joe Alfred Izen, Jr. (Izen), was counsel to Nassau Life. In the course of that representation, among other services, he prepared and issued two opinion letters that related to the multiple-entity tax shelter promoted by Nassau Life. In a legal opinion letter dated September 26, 1983, Izen discussed the legal status of "contractual trust companies" that were being promoted by Nassau Life (the 1983 opinion letter).

Ferber is a songwriter with a high school education. Anderson completed the eighth grade. At the time of hearing on the pending motions, Ferber was 36 years old and Anderson was 30 years old.

Ferber and Anderson met in India in 1977 and became friends. In late 1984, Anderson began to engage in an electronics business, VideoLab, as a sole proprietor. Because of his limited education, Anderson wanted to adopt a structure for VideoLab that would minimize the amount of paperwork that [*3] was necessary to carry on the business. He discussed his plans with Ferber, who was then employed as an information officer for Nassau Life. Ferber, relying at least partially on the 1983 opinion letter, advised Anderson, who also had access to the 1983 opinion letter, to structure his business as a trust such as those promoted by Nassau Life.

In January 1985, Anderson formed Para Tech as a common-law business trust. From its creation and thereafter, Para Tech conducted the business in which VideoLab had previously been engaged. Ferber was the trustee of Para Tech. The beneficial owner of Para Tech was another trust, Atram Investment Group (Atram), formed under the laws of the Turks and Caicos Islands, British West Indies. Anderson was one of the beneficiaries of Atram.

In a legal opinion letter prepared for Nassau Life dated June 20, 1985, Izen discussed the tax aspects of contractual trust companies

(the 1985 opinion letter). Among other things, the letter concluded that the grantor trust provisions of the Internal Revenue Code did not apply to "contractual trust companies". Izen's letter failed to discuss decided cases contrary to the positions he was espousing. Anderson [*4] and Ferber gained access to the 1985 opinion letter.

Respondent determined deficiencies in petitioners' Federal income taxes for1987 and 1988. Respondent determined that Para Tech was an association taxable as a corporation for Federal income tax purposes and disallowed its claimed distribution deductions. Respondent determined that Anderson and Ferber were each taxable on an amount equal to the taxable income of Para Tech. Respondent asserted three alternative theories in support of this determination. First, because Para Tech should be taxed as a corporation and because of their control over Para Tech and Atram, Anderson and Ferber were in constructive receipt of dividend income equal to the amounts transferred from Para Tech to Atram. Second, if Para Tech was a trust, it was a grantor trust owned by Anderson and Ferber, who were therefore taxable on Para Tech's income. Third, because both Para Tech and Atram were sham entities that should be disregarded for Federal income tax purposes, Anderson and Ferber are taxable on the income from Para Tech's business. Respondent also determined that all three petitioners are liable for additions to tax for fraud.

Para Tech, Anderson, [*5] and Ferber filed petitions for redetermination with this Court. Izen is counsel of record for petitioners in these cases. Nassau Life is bankrupt. All legal fees are being paid by Para Tech. No discovery and no settlement negotiations have taken place, and none of the cases has been set for trial.

Respondent's counsel in these cases wrote letters to Izen dated September 19, 1991, and November 15, 1991, questioning Izen regarding possible conflicts of interest in his representation of petitioners. Izen did not respond to these letters. Respondent, therefore, moved the Court to compel withdrawal of Izen as petitioners' counsel.

Discussion

Petitioners contend, based on *Appeal of Infotechnology, Inc.*, 582 A.2d 215 (Del. Super. 1990), that respondent lacks standing to make this motion because a nonclient litigant does not have the power to enforce a technical violation of the Model Rules of Professional Conduct (Model Rules). These cases, however, are distinguishable from

Appeal of Infotechnology, Inc., supra, in which the court held that it had "become apparent that * * * [the opposing party] was seeking to use disqualification as [*6] a litigation tactic." Id. at 221. The Court is generally reluctant to disqualify counsel of a taxpayer's choice on motion of the adversary. See *Alexander v. Superior Court*, 685 P.2d 1309, 1317 (Ariz. 1984). In these cases, however, respondent promptly moved for disqualification prior to conducting discovery or engaging in settlement negotiations and before these cases were set for trial. See *Duffey v. Commissioner*, 91 T.C. 81, 84 (1988).

Rule 201(a) provides that "Practitioners before the Court shall carry on their practice in accordance with the letter and spirit of the Model Rules". This Court, therefore, has the power to compel withdrawal of petitioners' counsel if such representation would violate the Model Rules. Specifically, Rule 24(f) provides:

If any counsel of record (1) was involved in planning or promoting a transaction or operating an entity that is connected to any issue in a case, [or] (2) represents more than one person with differing interests with respect to any issue in a case, * * * then such counsel must either secure the informed consent of the client * * *; withdraw [*7] from the case; or take whatever other steps are necessary to obviate a conflict of interest or other violation of the ABA Model Rules of Professional Conduct, and particularly [Rule] 1.7 * * *

Rule 24(f), which became effective July 1, 1990, emphasizes the provisions of the Model Rules to which practitioners before this Court were already subject. Rule 24(f) was added "to insure that the bar of this Court disclose or rectify any conflict of interest." Rules of Practice and Procedure of the United States Tax Court, 93 T.C. 821, 858 Note.

Model Rule 1.7(b) provides:

A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

(1) the lawyer reasonably believes the representation will not be adversely affected; and

(2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

Petitioners contend that Izen's representation [*8] of them does not violate Model Rule 1.7(b) because no potential conflict of interest exists among petitioners. Petitioners contend that each petitioner is

contesting the deficiency and will argue that Para Tech should be recognized as a trust and that Para Tech's Federal income tax returns for 1987 and 1988 were correct.

Respondent contends that Izen's representation of each petitioner may be materially limited by his responsibilities to the other petitioners and by his own interests. Respondent states: There are positions which can be advanced on behalf of each Petitioner which, if established, would enable that Petitioner to avoid liability for all or part of the deficiencies and additions to tax determined against that Petitioner, but which cannot be established without irreparably damaging some other Petitioner's case.

As set forth above, respondent determined that Anderson and Ferber were each taxable on an amount equal to the taxable income of Para Tech. One of respondent's alternative theories is that Para Tech is a grantor trust. Generally, the grantor trust rules apply to a person, such as Anderson, who created the trust. See secs. 671 through 678. Anderson formed [*9] the trust and transferred his business to it and is a beneficiary of the trust. Ferber, although serving as a trustee, is less likely to be a grantor. Ferber, and, hypothetically, Para Tech, would avoid taxation if respondent successfully established that the income was taxable to Anderson as the grantor.

Further, respondent has determined that each petitioner is liable for the additions to tax for fraud. In support of that determination, respondent's answer alleges that books and records made available to respondent during the examination of petitioners' returns were false and fraudulent, that petitioners "individually and in concert, refused to cooperate with Respondent's agents and attempted to obstruct Respondent's examination by various means", and that each petitioner understated or failed to report taxable income and tax due from them. In this regard, Anderson and Ferber can each argue that the other was responsible for maintaining the books and records of Para Tech and for preparing its tax returns and that each relied on the other. Each may also claim that he relied on Izen's opinion letters. In addition, Ferber, as trustee of Para Tech, is putatively making decisions [*10] for Para Tech, including using its funds to pay for litigation of these cases, while Anderson, not Ferber, has a beneficial interest in Para Tech.

Although it is too early in this litigation to anticipate all of the arguments that will be made, and the foregoing possibilities may not be the positions that petitioners should or will adopt at trial, there is a serious possibility that petitioners' positions may become adverse to

each other. See *Figueroa-Olmo v. Westinghouse Elec. Corp.*, 616 F.Supp. 1445, 1451-1454(D. Puerto Rico 1985); *Shadid v. Jackson*, 521 F.Supp. 87, 89 (E.D. Tex. 1981).

Izen's personal interests in this case may also conflict with the interests of petitioners. Anderson and Ferber relied, at least partially, on opinion letters that Izen had written. Therefore, Izen has an interest in vindicating the positions he took in the opinion letters in order to maintain his professional reputation and to protect himself from any potential future liability to petitioners. See, e.g., *Eisenberg v. Gagnon*, 766 F.2d 770, 779-780 (3d Cir. 1985) (holding that investors in a tax shelter [*11] could recover from an attorney who had misrepresented facts relating to the tax shelter). He would therefore be less likely to advise petitioners disinterestedly with regard to such matters as accepting a settlement offer. See Model Rules Rule 1.7(a) and 1.7 comment (1983) (stating that, "If the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice."). See also *Adams v. Commissioner*, 85 T.C. 359, 372-373 (1985). Izen's failure to advise petitioners of the potential adverse defenses or affirmative claims available to them would constitute a breach of his duty of loyalty to them. *Figueroa-Olmo v. Westinghouse Elec. Corp.*, supra at 1453-1454; *Eriks v. Denver*, 824 P.2d 1207, 1211-1212 (Wash. 1992) (citing Model Rules Rule 1.7 comment (1984) and holding that as a matter of law there was a conflict of interest between promoters of and investors in a tax shelter). Finally, Izen is potentially a witness with respect to matters set forth in his tax opinion, and testimony on that subject [*12] could appropriately be obtained without violation of the attorney-client privilege. See *In re Grand Jury Proceedings*, 727 F.2d 1352 (4th Cir. 1984); and *United States v. Jones*, 696 F.2d 1069 (4th Cir. 1982).

Izen and petitioners contend that petitioners have been informed of and waive Izen's conflict of interest. We are not persuaded, however, that the apparent consent of petitioners is informed and voluntary. They testified that they had no intention to sue either Nassau Life or Izen and that they understood that, if a dispute arose between Anderson and Ferber, Izen would have to withdraw. Neither Izen nor petitioners identified any disclosures of the potential adverse positions that might lead to a dispute between Anderson and Ferber. In this regard, Izen's questions and Anderson's responses at the hearing included the following:

Q As far as Fred [Ferber] is concerned, was there a discussion of any kind with Joe Alfred Izen, Jr., about what would happen if Fred

and yourself pointed the fingers at each other?

A Discussion with you or with Fred?

Q Either one, or both?

A We had – we had simply discussed the legal [*13] possibility that existed but did not see that as a reality or as even a plausible option for us to pursue.

Q Why wasn't it plausible?

A We both really have the same interests at heart, I believe, and I don't see what I would get out of, you know, trying to sue Fred. He has as much money as I do, which is almost nothing, so this question is going to come up later anyway, so –

Q Well, again, though, at the start of the lawsuit and with your discussions with your Attorney, Joe Alfred Izen, Jr., did you – were you and Fred Ferber more or less in agreement on the facts of how Para Technologies operated and who got what as far an any benefits or income; that's what I'm trying to ask?

A Well, yes, of course. I mean, Fred was Trustee and obviously, I need to be in agreement with what he's directing and have been, through the existence of the Trust.

Q Right. Was there any expression made that if a conflict between Fred and yourself were to arise based on changing representation of facts, that Joe Alfred Izen, Jr., might have to withdraw?

A I'm trying to remember the timing of this, of the various issues we had discussed. We had discussed that as a possibility, but I don't recall [*14] – I don't recall having the impression at that time that was very likely to happen.

Q Do you anticipate in this case any inconsistent defenses by you or Fred Ferber?

A No.

We are not persuaded that Izen made a full and fair disclosure or that petitioners understood the inherent potential conflicts between them. The backgrounds of the individuals suggest a lack of sophistication in assessing matters such as these, and they relied solely on the advice of Izen in deciding to waive the conflicts of interest. Compare *Adams v. Commissioner*, 85 T.C. at 372-374 (holding that taxpayers could not be relieved of a settlement agreement based on their attorney's conflict of interest because taxpayers were sophisticated, knew all of the relevant facts, and had been advised by independent counsel before employing the author of an opinion letter). It appears to us that the waiver is not based on informed consent but on the cost of employing independent and separate counsel and having such coun-

sel become familiar with the underlying facts of the cases.

Izen admitted during the hearing on respondent's motion that he had not secured written consents or waivers [*15] from petitioners and that he had not contacted Nassau Life or other beneficiaries of the Para Tech trust. Under these circumstances, we conclude that it is "more important that unethical conduct be prevented than * * * [that petitioners] have an unfettered right to counsel of * * * [their] choice." *Kevlik v. Goldstein*, 724 F.2d 844, 849 (1st Cir. 1984). The potential for unfairness to petitioners and damage to the integrity of the judicial process is too serious to permit Izen's representation of petitioners to continue, even in the face of an apparent waiver. *Figueroa-Olmo v. Westinghouse Elec. Corp.*, supra at 1451; *Shadid v. Jackson*, supra at 90; and Model Rules Rule 1.7 comment (1983) (stating that, "when a disinterested lawyer would conclude that the client should not agree to representation under the circumstances, the lawyer involved cannot * * * provide representation on the basis of the client's consent.")

Therefore, Izen must be disqualified from representing petitioners in these cases.

Respondent's motions will be granted.

APPENDIX I

Notice Of Deficiency

Department of the Treasury
Internal Revenue Service
District Director

Date: March 19, 1991
TIN: 544-90-8034
Person to Contact: D. Mills
Contact Telephone Number: 714-643-4343
Approved: Karen Reynolds, 3/4/91

Tom Anderson
1208 Broadway
Santa Monica, CA 90404-2761

Tax Year Ended:	Dec. 31, 1987	Dec. 31, 198[illegible]
Deficiency	$109,755	$71,720
Penalties:		
IRC 6653(b)(1)(A)	$82,316	
IRC 6653(b)(1)		$53,790
IRC 6653(b)(1)(B)	(50% of interest due on $109,755)	
IRC 6661	$27,439	$17,930

Dear Taxpayer:

We have determined that there is a deficiency (increase) in your income tax as shown above. This letter is a NOTICE OF DEFICIENCY sent to you as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this deficiency in court before making any payment, you have 90 days from the above mailing date of this letter (150 days if addressed to you outside the United States) to file a petition with the United States Tax Court for a redetermination of the deficiency. To secure the petition form, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. The completed petition form, together with a copy of this letter must be returned to the same address and received within 90 days from the above mailing date (150 days if addressed to you outside the United States).

The time in which you must file a petition with the Court (90 or 150 days as the case may be) is fixed by law and the Court cannot consider your case if your petition is filed late. If this letter is addressed to both a husband and wife, and both want to petition the Tax Court, both must sign the petition or each must file a separate signed petition.

If you dispute not more than $10,000 for any one tax year, a simplified procedure is provided by the Tax Court for small tax cases. You can get information about this procedure, as well as a petition form you can use, by writing to the Clerk of the United States Tax Court at 400 Second Street, N.W., Washington, D.C. 20217. You should do this promptly if you intend to file a petition with the Tax Court.

You may represent yourself before the Tax Court, or you may be represented by anyone admitted to practice before the Court. If you decide not to file a petition with the Tax Court, we would appreciate it if you would sign and return the enclosed waiver form. This will permit us to assess the deficiency quickly and will limit the accumulation of interest. The enclosed envelope is for your convenience. If you decide not to sign and return the statement and you do not timely petition the Tax Court, the law requires us to assess and bill you for the deficiency after 90 days from the above mailing date of this letter (150 days if this letter is addressed to you outside the United States).

If you have questions about this letter, please write to the person whose name and address are shown on this letter. If you write, please attach this letter to help identify your account. Keep the copy for your records. Also, please include your telephone number and the most convenient time for us to call, so we can contact you if we need additional information.

If you prefer, you may call the IRS contact person at the telephone number shown above. If this number is outside your local calling area, there will be a long distance charge to you.

You may call the IRS telephone number listed in your local directory. An IRS employee there may be able to help you, but the contact person at the address shown on this letter is most familiar with your case.

Thank you for your cooperation.

Sincerely yours,
Fred T. Goldberg, Jr., Commissioner
Jesse A. Cota, District Director

P.O. Box C-18, Laguna Niguel, CA 92677; Letter 531(DO)(Rev. 1-87)

Alternatives

In the alternative, if the fraud penalty is not sustained:
Negligence Penalties,

Year	1987	1988
IRC Section	6653(a)(1)(A)	6653(a)(1)
Underpayment	109,755	71,720
Rate:	.05	.05
Penalty:	5,488	3,586

End Alternatives

Income Tax Examination Changes
Form 4549-A

Tom Anderson
309 Broadway
Santa Monica, CA 90401-2313

TIN: 544-90-8034
Filing Status: Single
Return Form: 1040

Person with whom examination changes were discussed:
Tom Anderson (fraudulent entry, no discussion)

Adjustments to Income	1987	1988
Unreported Income — Para Tech	287,101	233,341
Total Adjustments	287,101	233,341
Taxable income shown on return	-338	-72
Corrected taxable income	286,763	233,269
Tax 87-Rate88-Rate	104,368	65,861
Corrected tax liability	104,368	65,861
Plus self employment tax	5,387	5,859
Total corrected income tax liability	109,755	71,720
Deficiency	109,755	71,720
Balance due not including interest or penalties	109,755	71,720
Penalties	109,755	71,720

Other information: none

Examiner's Signature: Larry Camporeale
District: Laguna Niguel
Date: 1/31/91
RAR V7.7 (01/10/91)
Form 9549-A

APPENDIX J

Constitution of The United States
Article I

Legislative Powers
Tribunals

Section 1. All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

Section 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

To borrow Money on the credit of the United States;

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;

To provide for the Punishment of counterfeiting the Securities and current Coin of the United States;

To establish Post Offices and post Roads;

To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;

To constitute Tribunals inferior to the supreme Court;

To define and punish Piracies and Felonies committed on the high Seas, and Offences against the Law of Nations;

To declare War, grant Letters of Marque and Reprisal, and make Rules concerning Captures on Land and Water;

To raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years;

To provide and maintain a Navy;

To make Rules for the Government and Regulation of the land and naval Forces;

To provide for calling forth the Militia to execute the Laws of the Union, suppress Insurrections and repeal Invasions;

To provide for organizing, arming, and disciplining, the Militia, and for governing such Part of them as may be employed in the Service of the United States, reserving to the States respectively, the Appointment of the Officers, and the Authority of training the Militia according to the discipline prescribed by Congress;

To exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of Particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards and other needful Buildings;–And

To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

APPENDIX K

Constitution of The United States
Amendment Article V

Due Process Of Law

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

APPENDIX L

Constitution of The United States
Amendment Article XVI

Income Tax

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

APPENDIX M

Technical and Miscellaneous Revenue Act of 1988
November 10, 1988
PUBLIC LAW 100-647; 100TH CONGRESS 2D SESSION;
H.R. 4333; 102 STAT. 3342
TITLE VI – OTHER SUBSTANTIVE REVENUE PROVISIONS
Subtitle J – Taxpayer Rights and Procedures
PART I – TAXPAYER RIGHTS

SEC. 6227. DISCLOSURE OF RIGHTS OF TAXPAYERS.

(a) IN GENERAL. – The Secretary of the Treasury shall, as soon as practicable, but not later than 180 days after the date of the enactment of this Act, prepare a statement which sets forth in simple and nontechnical terms –

(1) the rights of a taxpayer and the obligations of the Internal Revenue Service (hereinafter in this section referred to as the "Service") during an audit;

(2) the procedures by which a taxpayer may appeal any adverse decision of the Service (including administrative and judicial appeals);

(3) the procedures for prosecuting refund claims and filing of taxpayer complaints; and

(4) the procedures which the Service may use in enforcing the internal revenue laws (including assessment, jeopardy assessment, levy and distraint, and enforcement of liens).

(b) TRANSMISSION TO COMMITTEES OF CONGRESS. – The Secretary of the Treasury shall transmit drafts of the statement required under subsection (a) (or proposed revisions of any such statement) to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, and the Joint Committee on Taxation on the same day.

(c) DISTRIBUTION. – The statement prepared in accordance with subsections (a) and (b) shall be distributed by the Secretary of the Treasury to all taxpayers the Secretary contacts with respect to the determination or collection of any tax (other than by providing tax forms). The Secretary shall take such actions as the Secretary deems necessary to ensure that such distribution does not result in multiple statements being sent to any one taxpayer.

APPENDIX N

Authentication of the
Statement on Taxpayer Rights
by the Secretary of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON

May 16, 1995

Mr. Tom Anderson
6665 West Burnside Apt. 453
Portland, OR 97210

Dear Mr. Anderson:

This is in response to your March 27, 1995 FOIA request. Enclosed is IRS Publication 1, "Your Rights as a Taxpayer," which was prepared to satisfy the mandate under Public Law 100-647 section 6227(a).

Your FOIA request has also been referred to the IRS to respond to your request for copies of preliminary drafts and other materials related to the writing of the procedures. This office has no other documents responsive to your request.

Sincerely yours,

Ken Knopf
FOIA Officer
(Tax Policy)

Enclosure

APPENDIX O

Statement on Taxpayer Rights
by the Secretary of the Treasury
Pursuant to P.L. 100-647 §6227(a)

Department of the Treasury
Internal Revenue Service
Publication 1 (Rev. 10-90)
Cat. No. 64731W

YOUR RIGHTS AS A TAXPAYER

As a taxpayer, you have the right to be treated fairly, professionally, promptly, and courteously Internal Revenue Service employees. Our goal at the IRS is to protect your rights so that you will have the highest confidence in the integrity, efficiency, and fairness of our tax system. To ensure that you always receive such treatment, you should know about the many rights you have at each step of the tax process.

Free Information and Help in Preparing Returns

You have the right to information and help in complying with the tax laws. In addition to the basic instructions we provide with the tax forms, we make available a great deal of other information.

Taxpayer publications. We publish over 100 free taxpayer information publications on various topics. One of these, Publication 910, Guide to Free Tax Services, is a catalog of the free services and publications we offer. You can order all publications and any tax forms of instructions you need by calling us toll free at 1-800-TAX-FORM (829-3676).

Other assistance. We provide walk in tax help at many IRS offices and recorded information on many topics through our Tele-Tax system. The telephone numbers for Tele-Tax, and the topics covered, are in certain tax forms' instructions and publications. Many of our materials are available in Braille (at regional libraries for the handicapped) and in Spanish. We provide help for the hearing impaired via special telephone equipment.

We have informational videotapes that you can borrow. In addition, you may want to attend our education programs for specific groups of taxpayers, such as farmers and those with small businesses.

In cooperation with local volunteers, we offer free help in prepar-

ing tax returns for low income and elderly taxpayers through Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) Programs. You can get information on these programs by calling the toll free telephone number for your area.

Copies of tax returns. If you need a copy of your tax return for an earlier year, you can get one by filling out Form 4506, *Request for Copy of Tax Form*, and paying a small fee. However, you often only need certain information, such as the amount of your reported income, the number of your exemptions, and the tax shown on the return. You can get this information free if you write or visit an IRS office of call the toll free number for your area.

Privacy and Confidentiality

You have the right to have your personal and financial information kept confidential. People who prepare your return or represent you must keep your information confidential.

You also have the right to know why we are asking you for information, exactly how we will use any information you give, and what might happen if you do not give the information.

Information sharing. Under the law, we can share your tax information with State tax agencies and, under strict legal guidelines, the Department of Justice and other federal agencies. We can also share it with certain foreign governments under tax treaty provisions.

Courtesy and Consideration

You are always entitled to courteous and considerate treatment from IRS employees. If you ever feel that you are not being treated with fairness, courtesy, and consideration by an IRS employee, you should tell the employee's supervisor.

Complaints

If for any reason you have a complaint about the IRS, you may write to the District Director or Service Center Director for your area. We will give you the name and address if you call our toll free phone number listed later.

Representation and Recordings

Throughout you dealings with us, you can represent yourself, or, generally with proper written authorization, have someone represent you in your absence. During an interview, you can have someone accompany you.

If you want to consult an attorney, a certified public accountant, an enrolled agent, or any other person permitted to represent a taxpayer during an interview for examining a tax return or collecting tax, we will stop and reschedule the interview. We cannot suspend the interview if you are there because of an administrative summons.

You can generally make an audio recording of an interview with an IRS Collection or Examination officer. Your request to record the interview should be made in writing, and must be received 10 days before the interview. You must bring your own recording equipment. We also can record an interview. If we do so, we will notify you 10 days before the meeting and you can get a copy of the recording at your expense.

Payment of Only the Required Tax

You have the right to plan your business and personal finances so that you will pay the least tax that is due under the law. You are liable only for the correct amount of tax. Our purpose is to apply the law consistently and fairly to all taxpayers.

If Your Return is Questioned

We accept most taxpayer's returns as filed. If we inquire about your return or select it for examination, it does not suggest that you are dishonest. The inquiry or examination may or may not result in more tax. We may close your case without change; or, you may receive a refund.

Examination and inquiries by mail. We handle many examinations and inquiries entirely by mail. We will send you a letter with either a request for more information or a reason why we believe a change needs to be made to your return. If you give us the requested information or provide an explanation, we may or may not agree with you and we will explain the reasons for any changes. You should not hesitate to write us about anything you do not understand. If you cannot resolve any questions through the mail, you can request a personal interview. You can appeal through the IRS and the courts. You will find instructions with each inquiry or in Publication 1383, *Correspondence Process.*

Examination by interview. If we notify you that we will conduct your examination through a personal interview, or you request such an interview, you have the right to ask that the examination take place at a reasonable time and place that is convenient for both you and the IRS. If the time or place we suggest is not convenient, the examiner

will try to work out something more suitable. However, the IRS makes the final determination of how, when, and where the examination will take place. You will receive an explanation of your rights and of the examination process either before or at the interview.

If you do not agree with the examiner's report, you may meet with the examiner's supervisor to discuss your case further.

Repeat examinations. We try to avoid repeat examinations of the same items, but this sometimes happens. If we examined your tax return for the same items in either of the 2 previous years and proposed no change to your tax liability, please contact us as soon as possible so we can see if we should discontinue the repeat examination.

Explanation of changes. If we propose any changes to your return, we will explain the reasons for the changes. It is important that you understand these reasons. You should not hesitate to ask about anything that is unclear to you.

Interest. You must pay interest on additional tax that you owe. The interest is generally figured from the due date of the return. But if our error caused a delay in your case, and this was grossly unfair, we may reduce the interest. Only delays caused by procedural or mechanical acts not involving the exercise of judgement or discretion qualify. If you think we caused such a delay, please discuss it with the examiner and file a claim for refund.

Business taxpayers. If you are in an individual business, the rights covered in this publication generally apply to you. If you are a member of a partnership or a shareholder in a small business corporation, special rules may apply to the examination of your partnership of corporation items. The examination of partnership items is discussed in Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund.* The rights covered in this publication generally apply to exempt organizations and sponsors of employee plans.

Income Tax Appeal Procedure[1]

At any stage

You can agree and arrange to pay.

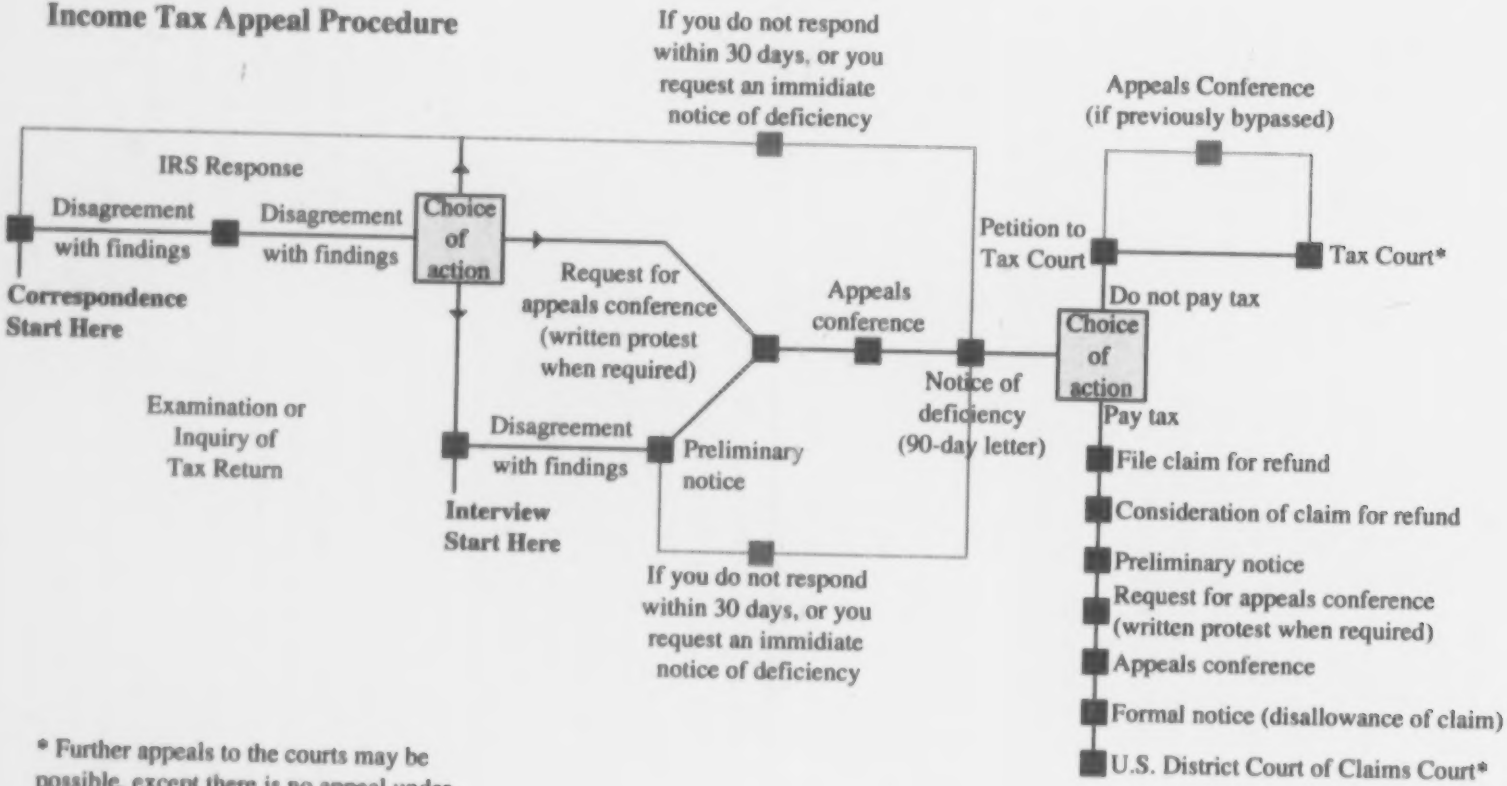
You can ask for a notice of deficiency so you can file a petition with the Tax Court.

You can pay the tax and file a claim for refund.

---

1. See following diagram from Secretary's statement:

Income Tax Appeal Procedure



* Further appeals to the courts may be possible, except there is no appeal under the Tax Court's small case procedure.

An Appeal of the Examination Findings

If you don't agree with the examiner's findings, you have the right to appeal them. During the examination process, you will be given information about your appeal rights. Publication 5, *Appeal Rights and Preparation of Protests for Unagreed Cases*, explains your appeal rights in detail and tells you exactly what to do if you want to appeal.

Appeals Office. You can appeal the findings of an examination within the IRS through our Appeals Office. Most differences can be settled through this appeals system without expensive and time consuming court trials. If the mater cannot be settled to your satisfaction in Appeals, you can then take your case to court.

Appeals to the courts. Depending on whether or not you first pay the disputed tax, you can take your case to the U.S. Tax Court, the U.S. Claims Court, or your U.S. District Court. These courts are entirely independent of the IRS. As always, you can represent yourself, or have someone admitted to practice before the court represent you.

If you disagree about whether you owe additional tax, you generally have the right to take your case to the U.S. Tax Court if you have not yet paid the tax. Ordinarily, you have 90 days from the mailing of a formal notice (called a "notice of deficiency") telling you that you owe additional tax, to file a petition with the U.S. Tax Court. You can request simplified small tax case procedures if your case is $10,000 or less for any period or year. A case settled under these procedures cannot be appealed.

If you already paid the disputed tax in full, you may file a claim for refund. If we disallow the claim, you can appeal the findings through our Appeals Office. If you do not accept their decison or we have not acted on your claim within 6 months, then you may take your case to the U.S. Claims Court or your U.S. District Court.

Recovering litigation expenses. If the court agrees with you on most issues in your case, and finds that our position was largely unjustified, you may be able to recover some of your administrative and litigation costs. To do this, you must have used all the administrative remedies available to you within the IRS. This includes going through our Appeals system and giving us all the information necessary to resolve the case.

Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, will help you more fully understand your appeal rights.

Fair Collection of Tax

Whenever you owe tax, we will send you a bill describing the tax and stating the amounts you owe in tax, interest, and penalties. Be sure to check any bill you receive to make sure it is correct. You have the right to have your bill adjusted if it is incorrect, so you should let us know about an incorrect bill right away.

If we tell you that you owe tax because of a math or clerical error on your return, you have the right to ask us to send you a formal notice (a "notice of deficiency") so that you can dispute the tax, as discussed earlier. You do not have to pay the additional tax at the same time that you ask us for the formal notice, if you ask for it within 60 days of the time we tell you of the error.

If the tax is correct we will give you a specific period of time to pay the bill in full. If you pay the bill within the time allowed, we will not have to take any further action.

We may request that you attend an interview for the collection of tax. You will receive an explanation of your rights and of the collection process either before or at the interview.

Your rights are further protected because we are not allowed to use tax enforcement results to evaluate our employees.

Payment arrangements. You should make every effort to pay your bill in full. If you can't, you should pay as much as you can and contact us right away. We may ask you for a complete financial statement to determine how you can pay the amount due. Based on your financial condition, you may qualify for an installment agreement. We can arrange for these payments to be made through payroll deduction. We will give you copies of all agreements you make with us.

If we approve a payment agreement, the agreement will stay in effect only if: you give correct and complete financial information, you pay each installment on time, you satisfy other tax liabilities on time, you provide current financial information when asked, and we determine that collecting the tax is not at risk.

Following a review of your current finances, we may change your payment agreement. We will notify you 30 days before any change to your payment agreement and tell you why we are making the change.

We will not take any enforcement action (such as recording a tax lien or levying on seized property), until after we have tried to contact you and given you the chance to voluntarily pay any tax due. Therefore, it is very important for you to respond right away to our attempts to contact you (by mail, telephone, or personal visit). If you do not respond, we may have no choice but to begin enforcement action.

Release of liens. If we have to place a lien on your property (to

secure the amount of tax due), we must release the lien no later than 30 days after finding that you have paid the entire tax and certain charges, the assessment has become legally unenforceable, or we have accepted a bond to cover the tax and certain charges.

Recovery of damages. If we knowingly or negligently fail to release a lien under the circumstances described above, and you suffer economic damages because of our failure, you can recover your actual economic damages and certain costs.

If we recklessly or intentionally fail to follow the laws and regulations for the collection of tax, you can recover actual economic damages and certain costs.

In each of the two situations above, damages and costs will be allowed within the following limits. You must exhaust all administrative remedies available to you. The damages will be reduced by the amount which you could have reasonably prevented. You must bring suit within 2 years of the action.

Incorrect lien. You have the right to appeal our filing of a Notice of Federal Tax Lien if you believe we filed the lien in error. If we agree, we will issue a certificate of release, including a statement that we filed the lien in error. A lien is incorrect if: you paid the entire amount due before we filed the lien, the time to collect the tax expired before we filed the lien, we made a procedural error in a deficiency assessment, or we assessed a tax in violation of the automatic stay provisions in a bankruptcy case.

Levy. We will generally give you 30 days notice before we levy on any property. The notice may be given to you in person, mailed to you, or left at your home or workplace. On the day you attend a collection interview because of a summons, we cannot levy your property unless the collection of tax is in jeopardy.

Property that is exempt from levy. If we must seize your property, you have the right to keep:
Necessary clothing and schoolbooks;
A limited amount of personal belongings, furniture, and business or professional books and tools;
Unemployment and job training benefits, workers' compensation, welfare, certain disability payments, and certain pension benefits;
the income you need to pay court ordered child support;
Mail;
An amount of weekly income equal to your standard deduction and allowable personal exemptions, divided by 52, and
Your main home, unless collection of tax is in jeopardy or the district

director (or assistant) approves the levy in writing.

If your bank account is levied after June 30, 1989, the bank will hold your account up to the amount of the levy for 21 days. This gives you time to settle any disputes concerning ownership of the funds in the account.

We generally must release a levy issued after June 30, 1989, if:
You pay the tax, penalty, and interest for which the levy was made;
The IRS determines the release will help collect the tax;
You have an approved installment agreement for the tax on the levy;
The IRS determines the levy is creating an economic hardship; or
The fair market value of property exceeds the amount of the levy and
Release would not hinder the collection of tax.

If at any time during the collection process you do not agree with the collection officer, you can discuss the case with his or her supervisor.

If we seize your property, you have the right to request that it be sold within 60 days after your request. You can request a time period greater than 60 days. We will comply with your request unless it is not in the best interest of the government.

Access to your private premises. A court order is not generally needed for a collection officer to seize your property. However, you don't have to allow the employee access to your private premises, such as your home or the nonpublic areas of your business, if the employee does not have court authorization to be there.

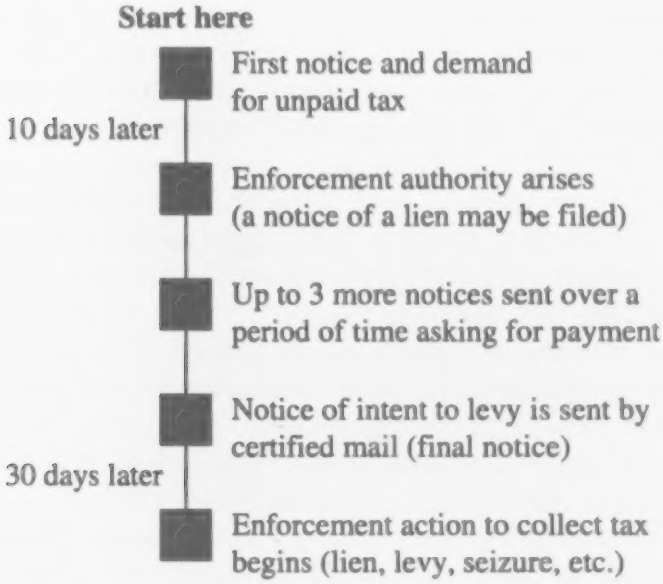
Withheld taxes. If we believe that you were responsible for seeing that a corporation paid us income and social security taxes withheld from its employees, and the taxes were not paid, we may look to you to pay an amount based on the unpaid taxes. If you feel that you don't owe this, you have the right to discuss the case with the collection officer's supervisor. You may also request an appeals hearing within 30 days of our proposed assessment of employment taxes. You generally have the same IRS appeal rights as other taxpayers. Because the Tax Court has no jurisdiction in this situation, you must pay at least part of the withheld taxes and file a claim for refund in order to take the matter to the U.S. District Court or U.S. Claims Court.

The amount of tax withheld from your wages is determined by the W-4, *Employees Withholding Allowance Certificate*, you give your employer. If your certificate is incorrect, the IRS may instruct your employer to increase the amount. We may also assess a penalty. You have the right to appeal the decision. Or, you can file a claim for refund and go to the U.S. Claims Court or U.S. District Court.

Publication 586A, *The Collection Process (Income Tax Accounts)*, and 594, *The Collection Process (Employment Tax Accounts)*, will help you understand your rights during the collection process.

The Collection Process

To stop the process at any stage, you should pay the tax in full. If you cannot pay the tax in full, contact us right away to discuss possible ways to pay the tax.



Refund of Overpaid Tax

Once you have paid all of your tax, you have the right to file a claim for a refund if you think the tax is incorrect. Generally, you have 3 years from the date you filed the return or 2 years from the date you paid the tax (whichever is later) to file a claim. If we examine your claim for any reason, you have the same rights that you would have during an examination of your return.

Interest on refunds. You will receive interest on any income tax refund delayed more than 45 days after the later of either the date you filed your return or the date your return was due.

Checking on your refund. Normally you will receive your refund about 6 weeks after you file your return. If you have not received your

refund within 8 weeks after mailing your return, you may check on it by calling the toll free Tele-Tax number in the tax forms' instructions.

If we reduce your refund because you owe a debt to another Federal agency or because you owe child support, we must notify you of this action. However, if you have a question about the debt that caused the reduction, you should contact the other agency.

Cancellation of Penalties

You have the right to ask that certain penalties (but not interest) be cancelled (abated) if you can show reasonable cause for the failure that led to the penalty (or can show that you exercised due diligence, if that is the applicable standard for that particular penalty.)

If you relied on wrong advice you received from IRS employees on the toll free telephone system, we will cancel certain penalties that may result. But you have to show that your reliance on the advice was reasonable.

If you relied on incorrect written advice from the IRS in response to a written request you made after January 1, 1989, we will cancel any penalties that may result. You must show that you gave sufficient and correct information and filed your return after you received the advice.

Special Help to Resolve Your Problems

We have a Problem Resolution Program for taxpayers who have been unable to resolve their problems with the IRS. If you have a tax problem that you cannot clear up through normal channels, write to the Problem Resolution Office in the district or Service Center with which you have the problem. You may also reach the Problem Resolution Office by calling the IRS taxpayer assistance numbers for your area. If you are hearing impaired with TV/Telephone (TTY) access, you may call 1-800-829-4059.

If your tax problem causes (or will cause) you to suffer a significant hardship, additional assistance is available. A significant hardship may occur if you cannot maintain necessities such as food, clothing, shelter, transportation, and medical treatment.

There are two ways you can apply for relief. You can submit Form 911, *Application for Taxpayer Assistance Order to Relieve Hardship*, which you can order by calling 1-800-TAX-FORM (829-3676). You can choose instead to call 1-800-829-1040, to request relief from your hardship. The Taxpayer Ombudsman, Problem Resolution Officer, or other official will then review your case and may issue a Taxpayer

Assistance Order (TAO), to suspend IRS action.

Taxpayer Assistance Numbers

You should use the telephone number shown in the white pages of your local telephone directory under U.S. Government, Internal Revenue Service, Federal Tax Assistance. If there is not a specific number listed, call toll free 1-800-829-1040.

You can also find these phone numbers in the instructions for Form 1040. You may also use these numbers to reach the Problem Resolution Office. Ask for the Problem Resolution Office when you call.

U.S. taxpayers abroad may write for information to:
Internal Revenue Service
Attn: IN:C:TPS
950 L'Enfant Plaza South, S.W.
Washington, D.C. 20024

You can also contact your nearest U.S. Embassy for information about what services and forms are available in your location.

APPENDIX P

IR-96-32
7/8/96

IRS Issues Revision of Publication Explaining Taxpayer's Rights

Washington – As part of its ongoing efforts to simplify the tax forms, tax information publications and other documents it sends to the public, the Internal Revenue Service has issued a new two-page version of Publication 1, "Your Rights as a Taxpayer." The revision is not only shorter and easier to understand, but it also features a new declaration of taxpayer's rights, highlighting the most important rights taxpayers have when doing business with the IRS.

Like the earlier version of Publication 1, the new revision explains taxpayer's rights when dealing with the IRS in the examination, appeals and collection processes. It also explains how taxpayers can file a claim for a refund and get additional tax information, including tax forms and publications by fax and from the Internet.

Included in the declaration of taxpayer rights highlighted in the new Publication 1 are: "protection of your rights," "privacy and confidentiality," "professional and courteous service" and "help from the Problem Resolution Office."

"The rights themselves are not new," said IRS Commissioner Margaret Milner Richardson. "The IRS has always recognized and respected taxpayer rights. By setting them forth in this declaration, we are emphasizing the importance we place on protecting taxpayers. rights and maintaining the public trust in the American system of voluntary tax compliance."

Like the current version of Publication 1, the revised publication will be included in initial correspondence and notices the IRS sends to taxpayers in connection with questions about their tax returns and tax accounts.

APPENDIX Q

Nondelegated Publication on Taxpayer Rights
by the Commissioner of Internal Revenue

Department of the Treasury
Internal Revenue Service

YOUR RIGHTS AS A TAXPAYER

The first part of this publication explains some of your most important rights as a taxpayer. The second part explains the examination, appeal, collection, and refund processes.

DECLARATION OF TEXPAYER RIGHTS

I. Protection of Your Rights

IRS employees will explain and protect your rights as a taxpayer throughout your contact with us.

II. Privacy and Confidentiality

The IRS will not disclose to anyone the information you give us, except as authorized by law. You have the right to know why we are asking you for information, how we will use it, and what happens if you do not provide requested information.

III. Professional and Courteous Service

If you believe that an IRS employee has not treated you in a professional manner, you should tell that employee's supervisor. If the supervisor's response is not satisfactory, you should write to your IRS District Director or Service Center Director.

IV. Representation

You may either represent yourself, or with proper written authorization, have someone else represent you in your place. You can have someone accompany you at an interview. You may make sound recordings of any meetings with our examination or collection personnel, provided you tell us in writing 10 days before the meeting.

V. Payment of Only The Correct Amount of Tax

You are responsible for paying only the correct amount of tax due

under the law—no more, no less.

VI. Help From The Problem Resolution Office

Problem Resolution Officers can help you with unresolved tax problems and can offer you special help if you have a significant hardship as a result of a tax problem. For more information, write to the Problem Resolution Office at the District Office or Service Center where you have the problem, or call 1-800-829-1040 (1-800-829-4059 for TDD users).

VII. Appeals and Judicial Review

If you disagree with us about the amount of your tax liability or certain collection actions, you have the right to ask the IRS Appeals Office to review your case. You may also ask a court to review your case.

VIII. Relief From Certain Penalties

The IRS will waive penalties when allowed by law if you can show you acted reasonably and in good faith or relied on the incorrect advice of an IRS employee.

EXAMINATIONS, APPEALS, COLLECTIONS, AND REFUNDS

Examinations (Audits)

We accept most taxpayer's returns as filed. If we inquire about your return or select it for examination, it does not suggest that you are dishonest. The inquiry or examination may or may not result in more tax. We may close your case without change; or, you may receive a refund.

By Mail

We handle many examinations and inquiries by mail. We will send you a letter with either a request for more information or a reason why we believe a change to your return may be needed. If you give us the requested information or provide an explanation, we may or may not agree with you, and we will explain the reasons for any changes. Please do not hesitate to write to us about anything you do not understand. If you cannot resolve a question through the mail, you can request a personal interview with an examiner.

By Interview

If we notify you that we will conduct your examination through a personal interview, or you request such an interview, you have the right to ask that the examination take place at a reasonable time and place that is convenient for both you and the IRS. At the end of your examination, the examiner will give you a report if there are any proposed changes to your tax return. If you do not agree with the report, you may meet with the examiners supervisor.

Repeat Examinations

If we examined your tax return for the same items in either of the 2 previous years and proposed no change to your tax liability, please contact us as soon as possible so we can determine if we should discontinue the repeat examination. Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, will give you more information about the rules and procedures of an IRS examination.

Appeals

If you do not agree with the examiner's findings, you can appeal them to our Appeals Office. Most differences can be settled without expensive and time consuming court trials. Your appeal rights are explained in detail in Publication 5, *Appeal Rights and Preparation of Protests for Unagreed Cases.*

If you do not wish to use our Appeals Office or disagree with its findings, you can take your case to the U.S. Tax Court, U.S. Court of Federal Claims, or the U.S. District Court where you live. If the court agrees with you on most issues in your case, and finds that our position was largely unjustified, you may be able to recover some of your administrative and litigation costs. You will not be eligible to recover these costs unless you tried to resolve your case administratively, including going through our appeals system, and you gave us all the information necessary to resolve the case.

Collections

Publication 594, *Understanding the Collection Process*, explains your rights and responsibilities regarding payment of federal taxes. It is divided into several sections that explain the procedures in plain language. The sections include:

1. *When you have not paid enough tax.* This section describes tax bills and explains what to do if you think your bill is wrong.

2. *Making arrangements to pay your bill.* This covers making install-

ment payments, delaying collection action, and submitting an offer in compromise.

3. *What happens when you take no action to pay.* This covers liens, releasing a lien, levies, releasing a levy, seizures and sales, and release of property. Publication 1660, *Collection Appeal rights (for Liens, Levies and Seizures)*, explains your rights to appeal liens, levies and seizures and how to request these appeals.

Refunds

You may file a claim for refund if you think you paid too much tax. You must generally file the claim within 3 years from the date you filed your return or 2 years from the date you paid the tax, whichever is later. The law generally provides for interest on your refund if it is not paid within 45 days of the date you filed your return or claim for refund. Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, has more information on refunds.

Tax Information

The IRS provides a great deal of free information. The following are sources for forms, publications and additional information:

(list of telephone numbers)

Department of the Treasury
Internal Revenue Service
Publication 1 (5-96)
Catalog Number 64731W

APPENDIX R

26 U.S.C. §1(c)

26 U.S.C. §1(c). Tax Imposed, Unmarried individuals (other than surviving spouses and heads of households)

There is hereby imposed on the taxable income of every individual (other than a surviving spouse as defined in section 2(a) or the head of a household as defined in section 2(b)) who is not a married individual (as defined in section 7703) a tax determined in accordance with the following table:

If taxable income is:	The tax is:
Not over $17,850	15% of taxable income.
Over $17,850	$2,677.50, plus 28% of the excess over $17,850.

APPENDIX S

26 U.S.C. §663

26 U.S.C. §663. Special rules applicable to sections 661 and 662.

(a) Exclusions. There shall not be included as amounts falling within section 661(a) or 662(a) —

(1) Gifts, bequests, etc.—Any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments. For this purpose an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money.

(2) Charitable, etc., distributions.—Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 642(c) (computed without regard to sections 508(d), 681, and 4948(c)(4)).

(3) Denial of double deduction.—Any amount paid, credited, or distributed in the taxable year, if section 651 or section 661 applied to such amount for a preceding taxable year of an estate or trust because credited or required to be distributed in such preceding taxable year.

(b) Distributions in first sixty-five days of taxable year.—

(1) General rule.—If within the first 65 days of any taxable year of a trust, an amount is properly paid or credited, such amount shall be considered paid or credited on the last day of the preceding taxable year.

(2) Limitation.—Paragraph (1) shall apply with respect to any taxable year of a trust only if the fiduciary of such trust elects, in such manner and at such time as the Secretary prescribes by regulations, to have paragraph (1) apply for such taxable year.

(c) Separate shares treated as separate trusts.—For the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary.

APPENDIX T

26 C.F.R. §1.663(c)

26 C.F.R. §1.663(c)-1 Separate shares treated as separate trusts; in general.

(a) If a single trust has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the amount of distributable net income allocable to the respective beneficiaries under sections 661 and 662. Application of this rule will be significant in, for example, situations in which income is accumulated for beneficiary A but a distribution is made to beneficiary B of both income and corpus in an amount exceeding the share of income that would be distributable to B had there been separate trusts. In the absence of a separate share rule B would be taxed on income which is accumulated for A. The division of distributable net income into separate shares will limit the tax liability of B. Section 663(c) does not affect the principles of applicable law in situations in which a single trust instrument creates not one but several separate trusts, as opposed to separate shares in the same trust within the meaning of this section.

(b) The separate share rule does not permit the treatment of separate shares as separate trusts for any purpose other than the application of distributable net income. It does not, for instance, permit the treatment of separate shares as separate trusts for purposes of:

(1) The filing of returns and payment of tax,

(2) The exclusion of dividends under section 116,

(3) The deduction of personal exemption under section 642(b), and

(4) The allowance to beneficiaries succeeding to the trust property of excess deductions and unused net operating loss and capital loss carryovers on termination of the trust under section 642(h).

(c) The separate share rule may be applicable even though separate and independent accounts are not maintained and are not required to be maintained for each share on the books of account of the trust, and even though no physical segregation of assets is made or required.

(d) Separate share treatment is not elective. Thus, if a trust is properly treated as having separate and independent shares, such treatment must prevail in all taxable years of the trust unless an event

occurs as a result of which the terms of the trust instrument and the requirements of proper administration require different treatment.

26 C.F.R. §1.663(c)-2 Computation of distributable net income.

The amount of distributable net income for any share under section 663(c) is computed for each share as if each share constituted a separate trust. Accordingly, any deduction or any loss which is applicable solely to one separate share of the trust is not available to any other share of the same trust.

26 C.F.R. §1.663(c)-3 Applicability of separate share rule.

(a) The applicability of the separate share rule provided by section 663(c) will generally depend upon whether distributions of the trust are to be made in substantially the same manner as if separate trusts had been created. Thus, if an instrument directs a trustee to divide the testator's residuary estate into separate shares (which under applicable law do not constitute separate trusts) for each of the testator's children and the trustee is given discretion, with respect to each share, to distribute or accumulate income or to distribute principal or accumulated income, or to do both, separate shares will exist under section 663(c). In determining whether separate shares exist, it is immaterial whether the principal and any accumulated income of each share is ultimately distributable to the beneficiary of such share, to his descendants, to his appointees under a general or special power of appointment, or to any other beneficiaries (including a charitable organization) designated to receive his share of the trust and accumulated income upon termination of the beneficiary's interest in the share. Thus, a separate share may exist if the instrument provides that upon the death of the beneficiary of the share, the share will be added to the shares of the other beneficiaries of the trust.

(b) Separate share treatment will not be applied to a trust or portion of a trust subject to a power to: (1) Distribute, apportion, or accumulate income, or (2) distribute corpus to or for one or more beneficiaries within a group or class of beneficiaries, unless payment of income, accumulated income, or corpus of a share of one beneficiary cannot affect the proportionate share of income, accumulated income, or corpus of any shares of the other beneficiaries, or unless substantially proper adjustment must thereafter be made (under the governing instrument) so that substantially separate and independent shares exist.

(c) A share may be considered as separate even though more than

one beneficiary has an interest in it. For example, two beneficiaries may have equal, disproportionate, or indeterminate interests in one share which is separate and independent from another share in which one or more beneficiaries have an interest. Likewise, the same person may be a beneficiary of more than one separate share.

(d) Separate share treatment may be given to a trust or portion of a trust otherwise qualifying under this section if the trust or portion of a trust is subject to a power to pay out to a beneficiary of a share (of such trust or portion) an amount of corpus in excess of his proportionate share of the corpus of the trust if the possibility of exercise of the power is remote. For example, if the trust is subject to a power to invade the entire corpus for the health, education, support, or maintenance of A, separate share treatment is applied if exercise of the power requires consideration of A's other income which is so substantial as to make the possibility of exercise of the power remote. If instead it appears that A and B have separate shares in a trust, subject to a power to invade the entire corpus for the comfort, pleasure, desire, or happiness of A, separate share treatment shall not be applied.

(e) For taxable years ending before December 31, 1978, the separate share rule may also be applicable to successive interests in point of time, as for instance in the case of a trust providing for a life estate to A and a second life estate or outright remainder to B. In such a case, in the taxable year of a trust in which a beneficiary dies items of income and deduction properly allocable under trust accounting principles to the period before a beneficiary's death are attributed to one share, and those allocable to the period after the beneficiary's death are attributed to the other share. Separate share treatment is not available to a succeeding interest, however, with respect to distributions which would otherwise be deemed distributed in a taxable year of the earlier interest under the throwback provisions of subpart D (section 665 and following), part I, subchapter J, chapter 1 of the Code. The application of this paragraph may be illustrated by the following example:

Example. A trust instrument directs that the income of a trust is to be paid to A for her life. After her death income may be distributed to B or accumulated. A dies on June 1, 1956. The trust keeps its books on the basis of the calendar year. The trust instrument permits invasions of corpus for the benefit of A and B, and an invasion of corpus was in fact made for A's benefit in 1956. In determining the distributable net income of the trust for the purpose of determining the

amounts includible in A's income, income and deductions properly allocable to the period before A's death are treated as income and deductions of a separate share; and for that purpose no account is taken of income and deductions allocable to the period after A's death.

(f) Separate share treatment is not applicable to an estate.

26 C.F.R. §1.663(c)-4 Example.

Section 663(c) may be illustrated by the following example:

Example. (a) A single trust was created in 1940 for the benefit of A, B, and C, who were aged 6, 4, and 2, respectively. Under the terms of the instrument, the trust income is required to be divided into three equal shares. Each beneficiary's share of the income is to be accumulated until he becomes 21 years of age. When a beneficiary reaches the age of 21, his share of the income may thereafter be either accumulated or distributed to him in the discretion of the trustee. The trustee also has discretion to invade corpus for the benefit of any beneficiary to the extent of his share of the trust estate, and the trust instrument requires that the beneficiary's right to future income and corpus will be proportionately reduced. When each beneficiary reaches 35 years of age, his share of the trust estate shall be paid over to him. The interest in the trust estate of any beneficiary dying without issue and before he has attained the age of 35 is to be equally divided between the other beneficiaries of the trust. All expenses of the trust are allocable to income under the terms of the trust instrument.

(b) No distributions of income or corpus were made by the trustee prior to 1955, although A became 21 years of age on June 30, 1954. During the taxable year of 1955, the trust has income from royalties of $20,000 and expenses of $5,000. The trustee in his discretion distributes $12,000 to A. Both A and the trust report on the calendar year basis.

(c) The trust qualifies for the separate share treatment under section 663(c) and the distributable net income must be divided into three parts for the purpose of determining the amount deductible by the trust under section 661 and the amount includible in A's gross income under section 662.

(d) The distributable net income of each share of the trust is $5,000 ($6,667 less $1,667). Since the amount ($12,000) distributed to A during 1955 exceeds the distributable net income of $5,000 allocated to his share, the trust is deemed to have distributed to him

$5,000 of 1955 income and $7,000 of amounts other than 1955 income. Accordingly, the trust is allowed a deduction of $5,000 under section 661. The taxable income of the trust for 1955 is $9,900, computed as follows:

Royalties	$20,000	
Deductions:		
Expenses	$5,000	
Distribution to A	5,000	
Personal exemption	100	
		10,100
Taxable income		9,900

(e) In accordance with section 662, A must include in his gross income for 1955 an amount equal to the portion ($5,000) of the distributable net income of the trust allocated to his share. Also, the excess distribution of $7,000 made by the trust is subject to the throwback provisions of subpart D (section 665 and following), part I, subchapter J, chapter 1 of the Code, and the regulations thereunder.

APPENDIX U

26 U.S.C. §674

26 U.S.C. §674. Power to control beneficial enjoyment

(a) General rule.—The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(b) Exceptions for certain powers.—Subsection (a) shall not apply to the following powers regardless of by whom held:

(1) Power to apply income to support of a dependent.—A power described in section 677(b) to the extent that the grantor would not be subject to tax under that section.

(2) Power affecting beneficial enjoyment only after occurrence of event.—A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the occurrence of the event unless the power is relinquished.

(3) Power exercisable only by will.—A power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(4) Power to allocate among charitable beneficiaries.—A power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions).

(5) Power to distribute corpus.—A power to distribute corpus either —

(A) to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite standard which is set forth in the trust instrument; or

(B) to or for any current income beneficiary, provided that the distribution of corpus must be chargeable against the propor-

tionate share of corpus held in trust for the payment of income to the beneficiary as if the corpus constituted a separate trust. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(6) Power to withhold income temporarily.—A power to distribute or apply income to or for any current income beneficiary or to accumulate the income for him, provided that any accumulated income must ultimately be payable —

(A) to the beneficiary from whom distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate, or

(B) on termination of the trust, or in conjunction with a distribution of corpus which is augmented by such accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument. Accumulated income shall be considered so payable although it is provided that if any beneficiary does not survive a date of distribution which could reasonably have been expected to occur within the beneficiary's lifetime, the share of the deceased beneficiary is to be paid to his appointees or to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children.

(7) Power to withhold income during disability of a beneficiary.—A power exercisable only during —

(A) the existence of a legal disability of any current income beneficiary, or

(B) the period during which any income beneficiary shall be under the age of 21 years, to distribute or apply income to or for such beneficiary or to accumulate and add the income to corpus. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to

a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(8) Power to allocate between corpus and income.—A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language.

(c) Exception for certain powers of independent trustees.—Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor —

(1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or

(2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries). A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children. For periods during which an individual is the spouse of the grantor (within the meaning of section 672(e)(2)), any reference in this subsection to the grantor shall be treated as including a reference to such individual.

(d) Power to allocate income if limited by a standard.—Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions of paragraph (6) or (7) of subsection (b) are satisfied, if such power is limited by a reasonably definite external standard which is set forth in the trust instrument. A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children.

APPENDIX V

26 C.F.R. §1.674

26 C.F.R. §1.674(a)-1 Power to control beneficial enjoyment; scope of section 674.

(a) Under section 674, the grantor is treated as the owner of a portion of trust if the grantor or a nonadverse party has a power, beyond specified limits, to dispose of the beneficial enjoyment of the income or corpus, whether the power is a fiduciary power, a power of appointment, or any other power. Section 674(a) states in general terms that the grantor is treated as the owner in every case in which he or a nonadverse party can affect the beneficial enjoyment of a portion of a trust, the limitations being set forth as exceptions in subsections (b), (c), and (d) of section 674. These exceptions are discussed in detail in §§ 1.674(b)-1 through 1.674(d)–1. Certain limitations applicable to section 674 (b), (c), and (d) are set forth in @ 1.674(d)-2. Section 674(b) describes powers which are excepted regardless of who holds them. Section 674(c) describes additional powers of trustees which are excepted if at least half the trustees are independent, and if the grantor is not a trustee. Section 674(d) describes a further power which is excepted if it is held by trustees other than the grantor or his spouse (if living with the grantor).

(b) In general terms the grantor is treated as the owner of a portion of a trust if he or a nonadverse party or both has a power to dispose of the beneficial enjoyment of the corpus or income unless the power is one of the following:

(1) Miscellaneous powers over either ordinary income or corpus. — (i) A power that can only affect the beneficial enjoyment of income (including capital gains) received after a period of time such that the grantor would not be treated as an owner under section 673 if the power were a reversionary interest (section 674(b)(2));

(ii) A testamentary power held by anyone (other than a testamentary power held by the grantor over accumulated income) (section 674(b)(3));

(iii) A power to choose between charitable beneficiaries or to affect the manner of their enjoyment of a beneficial interest (section 674(b)(4));

(iv) A power to allocate receipts and disbursements between income and corpus (section 674(b)(8)).

(2) Powers of distribution primarily affecting only one benefi-

ciary. —(i) A power to distribute corpus to or for a current income beneficiary, if the distribution must be charged against the share of corpus from which the beneficiary may receive income (section 674(b)(5)(B));

(ii) A power to distribute income to or for a current income beneficiary or to accumulate it either (a) if accumulated income must either be payable to the beneficiary from whom it was withheld or as described in paragraph (b)(6) of @ 1.674(b)-1 (section 674(b) (6)); (b) if the power is to apply income to the support of a dependent of the grantor, and the income is not so applied (section 674(b)(1)); or (c) if the beneficiary is under 21 or under a legal disability and accumulated income is added to corpus (section 674(b)(7)).

(3) Powers of distribution affecting more than one beneficiary. A power to distribute corpus or income to or among one or more beneficiaries or to accumulate income, either (i) if the power is held by a trustee or trustees other than the grantor, at least half of whom are independent (section 674(c)), or (ii) if the power is limited by a reasonably definite standard in the trust instrument, and in the case of a power over income, if in addition the power is held by a trustee or trustees other than the grantor and the grantor's spouse living with the grantor (section 674(b)(5)(A) and (d)). (These powers include both powers to "sprinkle" income or corpus among current beneficiaries, and powers to shift income or corpus between current beneficiaries and remaindermen; however, certain of the powers described under subparagraph (2) of this paragraph can have the latter effect incidentally.)

(c) See section 671 and §§ 1.671-2 and 1.671-3 for rules for the treatment of income, deductions, and credits when a person is treated as the owner of all or only a portion of a trust.

26 C.F.R. §1.674(b)-1 Excepted powers exercisable by any person.

(a) Paragraph (b) (1) through (8) of this section sets forth a number of powers which may be exercisable by any person without causing the grantor to be treated as an owner of a trust under section 674(a). Further, with the exception of powers described in paragraph (b)(1) of this section, it is immaterial whether these powers are held in the capacity of trustee. It makes no difference under section 674(b) that the person holding the power is the grantor, or a related or subordinate party (with the qualifications noted in paragraph (b) (1) and (3) of this section).

(b) The exceptions referred to in paragraph (a) of this section are as follows (see, however, the limitations set forth in @ 1.674(d)-2):

(1) Powers to apply income to support of a dependent. Section 674(b)(1) provides, in effect, that regardless of the general rule of section 674(a), the income of a trust will not be considered as taxable to the grantor merely because in the discretion of any person (other than a grantor who is not acting as a trustee or co-trustee) it may be used for the support of a beneficiary whom the grantor is legally obligated to support, except to the extent that it is in fact used for that purpose. See section 677(b) and the regulations thereunder.

(2) Powers affecting beneficial enjoyment only after a period. Section 674(b)(2) provides an exception to section 674(a) if the exercise of a power can only affect the beneficial enjoyment of the income of a trust received after a period of time which is such that a grantor would not be treated as an owner under section 673 if the power were a reversionary interest. See §§ 1.673(a)-1 and 1.673(b)-1. For example, if a trust created on January 1, 1955, provides for the payment of income to the grantor's son, and the grantor reserves the power to substitute other beneficiaries of income or corpus in lieu of his son on or after January 1, 1965, the grantor is not treated under section 674 as the owner of the trust with respect to ordinary income received before January 1, 1965. But the grantor will be treated as an owner on and after that date unless the power is relinquished. If the beginning of the period during which the grantor may substitute beneficiaries is postponed, the rules set forth in @ 1.673(d)-1 are applicable in order to determine whether the grantor should be treated as an owner during the period following the postponement.

(3) Testamentary powers. Under paragraph (3) of section 674(b) a power in any person to control beneficial enjoyment exercisable only by will does not cause a grantor to be treated as an owner under section 674(a). However, this exception does not apply to income accumulated for testamentary disposition by the grantor or to income which may be accumulated for such distribution in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party. For example, if a trust instrument provides that the income is to be accumulated during the grantor's life and that the grantor may appoint the accumulated income by will, the grantor is treated as the owner of the trust. Moreover, if a trust instrument provides that the income is payable to another person for his life, but the grantor has a testamentary power of appointment over the remainder, and under the trust instrument

and local law capital gains are added to corpus, the grantor is treated as the owner of a portion of the trust and capital gains and losses are included in that portion. (See @ 1.671-3.)

(4) Powers to determine beneficial enjoyment of charitable beneficiaries. Under paragraph (4) of section 674(b) a power in any person to determine the beneficial enjoyment of corpus or income which is irrevocably payable (currently or in the future) for purposes specified in section 170(c) (relating to definition of charitable contributions) will not cause the grantor to be treated as an owner under section 674(a). For example, if a grantor creates a trust, the income of which is irrevocably payable solely to educational or other organizations that qualify under section 170(c), he is not treated as an owner under section 674 although he retains the power to allocate the income among such organizations.

(5) Powers to distribute corpus. Paragraph (5) of section 674(b) provides an exception to section 674(a) for powers to distribute corpus, subject to certain limitations, as follows:

(i) If the power is limited by a reasonably definite standard which is set forth in the trust instrument, it may extend to corpus distributions to any beneficiary or beneficiaries or class of beneficiaries (whether income beneficiaries or remaindermen) without causing the grantor to be treated as an owner under section 674. See section 674(b)(5)(A). It is not required that the standard consist of the needs and circumstances of the beneficiary. A clearly measurable standard under which the holder of a power is legally accountable is deemed a reasonably definite standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; or to enable him to maintain his accustomed standard of living; or to meet an emergency, would be limited by a reasonably definite standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not limited by a reasonably definite standard. The entire context of a provision of a trust instrument granting a power must be considered in determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no reasonably definite standard exists.

(ii) If the power is not limited by a reasonably definite

standard set forth in the trust instrument, the exception applies only if distributions of corpus may be made solely in favor of current income beneficiaries, and any corpus distribution to the current income beneficiary must be chargeable against the proportionate part of corpus held in trust for payment of income to that beneficiary as if it constituted a separate trust (whether or not physically segregated). See section 674(b)(5)(B).

(iii) This subparagraph may be illustrated by the following examples:

Example 1. A trust instrument provides for payment of the income to the grantor's two brothers for life, and for payment of the corpus to the grantor's nephews in equal shares. The grantor reserves the power to distribute corpus to pay medical expenses that may be incurred by his brothers or nephews. The grantor is not treated as an owner by reason of this power because section 674(b)(5)(A) excepts a power, exercisable by any person, to invade corpus for any beneficiary, including a remainderman, if the power is limited by a reasonably definite standard which is set forth in the trust instrument. However, if the power were also exercisable in favor of a person (for example, a sister) who was not otherwise a beneficiary of the trust, section 674(b)(5)(A) would not be applicable.

Example 2. The facts are the same as in example 1 except that the grantor reserves the power to distribute any part of the corpus to his brothers or to his nephews for their happiness. The grantor is treated as the owner of the trust. Paragraph (5)(A) of section 674(b) is inapplicable because the power is not limited by a reasonably definite standard. Paragraph (5)(B) is inapplicable because the power to distribute corpus permits a distribution of corpus to persons other than current income beneficiaries.

Example 3. A trust instrument provides for payment of the income to the grantor's two adult sons in equal shares for 10 years, after which the corpus is to be distributed to his grandchildren in equal shares. The grantor reserves the power to pay over to each son up to one-half of the corpus during the 10-year period, but any such payment shall proportionately reduce subsequent income and corpus payments made to the son receiving the corpus. Thus, if one-half of the corpus is paid to one son, all the income from the remaining half is thereafter payable to the other son. The grantor is not treated as an owner under section 674(a) by reason of this power because it qualifies under the exception of section 674(b)(5)(B).

(6) Powers to withhold income temporarily. (i) Section

674(b)(6) excepts a power which, in general, enables the holder merely to effect a postponement in the time when the ordinary income is enjoyed by a current income beneficiary. Specifically, there is excepted a power to distribute or apply ordinary income to or for a current income beneficiary or to accumulate the income, if the accumulated income must ultimately be payable either:

(*a*) To the beneficiary from whom it was withheld, his estate, or his appointees (or persons designated by name, as a class, or otherwise as alternate takers in default of appointment) under a power of appointment held by the beneficiary which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate (section 674(b)(6)(A));

(*b*) To the beneficiary from whom it was withheld, or if he does not survive a date of distribution which could reasonably be expected to occur within his lifetime, to his appointees (or alternate takers in default of appointment) under any power of appointment, general or special, or if he has no power of appointment to one or more designated alternate takers (other than the grantor of the grantor's estate) whose shares have been irrevocably specified in the trust instrument (section 674(b)(6)(A) and the flush material following); or

(*c*) On termination of the trust, or in conjunction with a distribution of corpus which is augmented by the accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument, or if any beneficiary does not survive a date of distribution which would reasonably be expected to occur within his lifetime, to his appointees (or alternate takers in default of appointment) under any power of appointment, general or special, or if he has no power of appointment to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified in the trust instrument (section 674(b)(6)(B) and the flush material following).

(In the application of (*a*) of this subdivision, if the accumulated income of a trust is ultimately payable to the estate of the current income beneficiary or is ultimately payable to his appointees or takers in default of appointment, under a power of the type described in (*a*) of this subdivision, it need not be payable to the beneficiary from whom it was withheld under any circumstances. Furthermore, if a trust otherwise qualifies for the exception in (*a*) of this subdivision

the trust income will not be considered to be taxable to the grantor under section 677 by reason of the existence of the power of appointment referred to in (*a*) of this subdivision.) In general, the exception in section 674(b)(6) is not applicable if the power is in substance one to shift ordinary income from one beneficiary to another. Thus, a power will not qualify for this exception if ordinary income may be distributed to beneficiary A, or may be added to corpus which is ultimately payable to beneficiary B, a remainderman who is not a current income beneficiary. However, section 674(b)(6)(B), and (*c*) of this subdivision, permit a limited power to shift ordinary income among current income beneficiaries, as illustrated in example 1 of this subparagraph.

(ii) The application of section 674(b)(6) may be illustrated by the following examples:

Example 1. A trust instrument provides that the income shall be paid in equal shares to the grantor's two adult daughters but the grantor reserves the power to withhold from either beneficiary any part of that beneficiary's share of income and to add it to the corpus of the trust until the younger daughter reaches the age of 30 years. When the younger daughter reaches the age of 30, the trust is to terminate and the corpus is to be divided equally between the two daughters or their estates. Although exercise of this power may permit the shifting of accumulated income from one beneficiary to the other (since the corpus with the accumulations is to be divided equally) the power is excepted under section 674(b)(6)(B) and subdivision (i)(c) of this subparagraph.

Example 2. The facts are the same as in example 1, except that the grantor of the trust reserves the power to distribute accumulated income to the beneficiaries in such shares as he chooses. The combined powers are not excepted by section 674(b)(6)(B) since income accumulated pursuant to the first power is neither required to be payable only in conjunction with a corpus distribution nor required to be payable in shares specified in the trust instrument. See, however, section 674(c) and @ 1.674(c)-1 for the effect of such a power if it is exercisable only by independent trustees.

Example 3. A trust provides for payment of income to the grantor's adult son with the grantor retaining the power to accumulate the income until the grantor's death, when all accumulations are to be paid to the son. If the son predeceases the grantor, all accumulations are, at the death of the grantor, to be paid to his daughter, or if she is not living, to alternate takers (which do not include the

grantor's estate) in specified shares. The power is excepted under section 674(b)(6)(A) since the date of distribution (the date of the grantor's death) may, in the usual case, reasonably be expected to occur during the beneficiary's (the son's) lifetime. It is not necessary that the accumulations be payable to the son's estate or his appointees if he should predecease the grantor for this exception to apply.

(7) Power to withhold income during disability. Section 674(b)(7) provides an exception for a power which, in general, will permit ordinary income to be withheld during the legal disability of an income beneficiary or while he is under 21. Specifically, there is excepted a power, exercisable only during the existence of a legal disability of any current income beneficiary or the period during which any income beneficiary is under the age of 21 years, to distribute or apply ordinary income to or for that beneficiary or to accumulate the income and add it to corpus. To qualify under this exception it is not necessary that the income ultimately be payable to the income beneficiary from whom it was withheld, his estate, or his appointees; that is, the accumulated income may be added to corpus and ultimately distributed to others. For example, the grantor is not treated as an owner under section 674 if the income of a trust is payable to his son for life, remainder to his grandchildren, although he reserves the power to accumulate income and add it to corpus while his son is under 21.

(8) Powers to allocate between corpus and income. Paragraph (8) of section 674(b) provides that a power to allocate receipts and disbursements between corpus and income, even though expressed in broad language, will not cause the grantor to be treated as an owner under the general rule of section 674(a).

26 C.F.R. §1.674(c)-1 Excepted powers exercisable only by independent trustees.

Section 674(c) provides an exception to the general rule of section 674(a) for certain powers that are exercisable by independent trustees. This exception is in addition to those provided for under section 674(b) which may be held by any person including an independent trustee. The powers to which section 674(c) apply are powers (a) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, or (b) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries). In order for such a power to fall within the exception of section

674(c) it must be exercisable solely (without the approval or consent of any other person) by a trustee or trustees none of whom is the grantor and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor. (See section 672(c) for definitions of these terms.) An example of the application of section 674(c) is a trust whose income is payable to the grantor's three adult sons with power in an independent trustee to allocate without restriction the amounts of income to be paid to each son each year. Such a power does not cause the grantor to be treated as the owner of the trust. See however, the limitations set forth in @ 1.674(d)-2.

26 C.F.R. §1.674(d)-1 Excepted powers exercisable by any trustee other than grantor or spouse.

Section 674(d) provides an additional exception to the general rule of section 674(a) for a power to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries or to, for, or within a class of beneficiaries, whether or not the conditions of section 674(b) (6) or (7) are satisfied, if the power is solely exercisable (without the approval or consent of any other person) by a trustee or trustees none of whom is the grantor or spouse living with the grantor, and if the power is limited by a reasonably definite external standard set forth in the trust instrument (see paragraph (b)(5) of @ 1.674(b)-1 with respect to what constitutes a reasonably definite standard). See, however, the limitations set forth in @ 1.674(d)-2.

26 C.F.R. §1.674(d)-2 Limitations on exceptions in section 674 (b), (c), and (d).

(a) Power to remove trustee. A power in the grantor to remove, substitute, or add trustees (other than a power exercisable only upon limited conditions which do not exist during the taxable year, such as the death or resignation of, or breach of fiduciary duty by, an existing trustee) may prevent a trust from qualifying under section 674 (c) or (d). For example, if a grantor has an unrestricted power to remove an independent trustee and substitute any person including himself as trustee, the trust will not qualify under section 674 (c) or (d). On the other hand if the grantor's power to remove, substitute, or add trustees is limited so that its exercise could not alter the trust in a manner that would disqualify it under section 674 (c) or (d), as the case may be, the power itself does not disqualify the trust. Thus, for example, a power in the grantor to remove or discharge an independent trustee

on the condition that he substitute another independent trustee will not prevent a trust from qualifying under section 674(c).

(b) Power to add beneficiaries. The exceptions described in section 674 (b) (5), (6), and (7), (c), and (d), are not applicable if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where the action is to provide for after-born or after-adopted children. This limitation does not 26 CFR 1.674(d)-2 apply to a power held by a beneficiary to substitute other beneficiaries to succeed to his interest in the trust (so that he would be an adverse party as to the exercise or nonexercise of that power). For example, the limitation does not apply to a power in a beneficiary of a nonspendthrift trust to assign his interest. Nor does the limitation apply to a power held by any person which would qualify as an exception under section 674(b)(3) (relating to testamentary powers).

APPENDIX W

26 U.S.C. §6211

26 U.S.C. §6211. Definition of a deficiency

(a) In general.—For purposes of this title in the case of income, estate, and gift taxes imposed by subtitles A and B and excise taxes imposed by chapters 41, 42, 43, and 44 the term "deficiency" means the amount by which the tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44 exceeds the excess of —

(1) the sum of—

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over —

(2) the amount of rebates, as defined in subsection (b)(2), made.

(b) Rules for application of subsection (a). —For purposes of this section —

(1) The tax imposed by subtitle A and the tax shown on the return shall both be determined without regard to payments on account of estimated tax, without regard to the credit under section 31, without regard to the credit under section 33, and without regard to any credits resulting from the collection of amounts assessed under section 6851 or 6852 (relating to termination assessments).

(2) The term "rebate" means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed by subtitle A or B or chapter 41, 42, 43, or 44 was less than the excess of the amount specified in subsection (a)(1) over the rebates previously made.

(3) The computation by the Secretary, pursuant to section 6014, of the tax imposed by chapter 1 shall be considered as having been made by the taxpayer and the tax so computed considered as shown by the taxpayer upon his return.

(4) For purposes of subsection (a) —

(A) any excess of the sum of the credits allowable under sections 32 and 34 over the tax imposed by subtitle A (determined without regard to such credits), and

(B) any excess of the sum of such credits as shown by the taxpayer on his return over the amount shown as the tax by the tax-

payer on such return (determined without regard to such credits), shall be taken into account as negative amounts of tax.

APPENDIX X

26 U.S.C. §6212

26 U.S.C. §6212. Notice of deficiency

(a) In general.— If the Secretary determines that there is a deficiency in respect of any tax imposed by subtitles A or B or chapter 41, 42, 43, or 44 he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.

(b) Address for notice of deficiency.—

(1) Income and gift taxes and certain excise taxes.—In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, or chapter 44 if mailed to the taxpayer at his last known address, shall be sufficient for purposes of subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, chapter 44, and this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(2) Joint income tax return.—In the case of a joint income tax return filed by husband and wife, such notice of deficiency may be a single joint notice, except that if the Secretary has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, a duplicate original of the joint notice shall be sent by certified mail or registered mail to each spouse at his last known address.

(3) Estate tax.—In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by chapter 11, if addressed in the name of the decedent or other person subject to liability and mailed to his last known address, shall be sufficient for purposes of chapter 11 and of this chapter.

(c) Further deficiency letters restricted.—

(1) General rule.—If the Secretary has mailed to the taxpayer a notice of deficiency as provided in subsection (a), and the taxpayer files a petition with the Tax Court within the time prescribed in section 6213(a), the Secretary shall have no right to determine any additional deficiency of income tax for the same taxable year, of gift tax for the same calendar year, of estate tax in respect of the taxable estate of the same decedent, of chapter 41 tax for the same taxable year, of chapter 43 tax for the same taxable year, of chapter 44 tax for

the same taxable year, of section 4940 tax for the same taxable year, or of chapter 42 tax, (other than under section 4940) with respect to any act (or failure to act) to which such petition relates, except in the case of fraud, and except as provided in section 6214(a) (relating to assertion of greater deficiencies before the Tax Court), in section 6213(b)(1) (relating to mathematical or clerical errors), in section 6851 or 6852 (relating to termination assessments), or in section 6861(c) (relating to the making of jeopardy assessments).

(2) Cross references For assessment as a deficiency notwithstanding the prohibition of further deficiency letters, in the case of -

(A) Deficiency attributable to change of treatment with respect to itemized deductions, see section 63(e)(3).

(B) Deficiency attributable to gain on involuntary conversion, see section 1033(a)(2)(C) and (D).

(C) Deficiency attributable to gain on sale or exchange of principal residence, see section 1034(j). ((D) Repealed. Pub. L. 94-455, title XIX, Sec. 1901(b)(37)(C), Oct. 4, 1976, 90 Stat. 1803) (E) Deficiency attributable to activities not engaged in for profit, see section 183(e)(4). For provisions allowing determination of tax in title 11 cases, see section 505(a) of title 11 of the United States Code.

(d) Authority to rescind notice of deficiency with taxpayer's consent.—The Secretary may, with the consent of the taxpayer, rescind any notice of deficiency mailed to the taxpayer. Any notice so rescinded shall not be treated as a notice of deficiency for purposes of subsection (c)(1) (relating to further deficiency letters restricted), section 6213(a) (relating to restrictions applicable to deficiencies; petition to Tax Court), and section 6512(a) (relating to limitations in case of petition to Tax Court), and the taxpayer shall have no right to file a petition with the Tax Court based on such notice. Nothing in this subsection shall affect any suspension of the running of any period of limitations during any period during which the rescinded notice was outstanding.

APPENDIX Y

26 U.S.C. §6213

26 U.S.C. §6213. Restrictions applicable to deficiencies; petition to Tax Court.

(a) Time for filing petition and restriction on assessment.—

Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in section 6851, 6852, or 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A, or B, chapter 41, 42, 43, or 44 and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421(a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action or proceeding under this subsection unless a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition.

(b) Exceptions to restrictions on assessment.—

(1) Assessments arising out of mathematical or clerical errors

If the taxpayer is notified that, on account of a mathematical or clerical error appearing on the return, an amount of tax in excess of that shown on the return is due, and that an assessment of the tax has been or will be made on the basis of what would have been the correct amount of tax but for the mathematical or clerical error, such notice shall not be considered as a notice of deficiency for the purposes of subsection (a) (prohibiting assessment and collection until notice of the deficiency has been mailed), or of section 6212(c)(1) (restricting further deficiency letters), or of section 6512(a) (prohibiting credits or refunds after petition to the Tax Court), and the taxpayer shall have no right to file a petition with the Tax Court based on such notice, nor shall such assessment or collection be prohibited by

the provisions of subsection (a) of this section. Each notice under this paragraph shall set forth the error alleged and an explanation thereof.

(2) Abatement of assessment of mathematical or clerical errors.—

(A) Request for abatement.—Notwithstanding section 6404(b), a taxpayer may file with the Secretary within 60 days after notice is sent under paragraph (1) a request for an abatement of any assessment specified in such notice, and upon receipt of such request, the Secretary shall abate the assessment. Any reassessment of the tax with respect to which an abatement is made under this subparagraph shall be subject to the deficiency procedures prescribed by this subchapter.

(B) Stay of collection.—In the case of any assessment referred to in paragraph (1), notwithstanding paragraph (1), no levy or proceeding in court for the collection of such assessment shall be made, begun, or prosecuted during the period in which such assessment may be abated under this paragraph.

(3) Assessments arising out of tentative carryback or refund adjustments.—If the Secretary determines that the amount applied, credited, or refunded under section 6411 is in excess of the overassessment attributable to the carryback or the amount described in section 1341(b)(1) with respect to which such amount was applied, credited, or refunded, he may assess without regard to the provisions of paragraph (2) the amount of the excess as a deficiency as if it were due to a mathematical or clerical error appearing on the return.

(4) Assessment of amount paid.—Any amount paid as a tax or in respect of a tax may be assessed upon the receipt of such payment notwithstanding the provisions of subsection (a). In any case where such amount is paid after the mailing of a notice of deficiency under section 6212, such payment shall not deprive the Tax Court of jurisdiction over such deficiency determined under section 6211 without regard to such assessment.

(c) Failure to file petition.—If the taxpayer does not file a petition with the Tax Court within the time prescribed in subsection (a), the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the Secretary.

(d) Waiver of restrictions

The taxpayer shall at any time (whether or not a notice of deficiency has been issued) have the right, by a signed notice in writing

filed with the Secretary, to waive the restrictions provided in subsection (a) on the assessment and collection of the whole or any part of the deficiency.

(e) Suspension of filing period for certain excise taxes

The running of the time prescribed by subsection (a) for filing a petition in the Tax Court with respect to the taxes imposed by section 4941 (relating to taxes on self-dealing), 4942 (relating to taxes on failure to distribute income), 4943 (relating to taxes on excess business holdings), 4944 (relating to investments which jeopardize charitable purpose), 4945 (relating to taxes on taxable expenditures), 4951 (relating to taxes on self-dealing), or 4952 (relating to taxes on taxable expenditures), 4955 (relating to taxes on political expenditures), 4971 (relating to excise taxes on failure to meet minimum funding standard), 4975 (relating to excise taxes on prohibited transactions) shall be suspended for any period during which the Secretary has extended the time allowed for making correction under section 4963(e).

(f) Coordination with title 11.—

(1) Suspension of running of period for filing petition in title 11 cases.—In any case under title 11 of the United States Code, the running of the time prescribed by subsection (a) for filing a petition in the Tax Court with respect to any deficiency shall be suspended for the period during which the debtor is prohibited by reason of such case from filing a petition in the Tax Court with respect to such deficiency, and for 60 days thereafter.

(2) Certain action not taken into account.—For purposes of the second and third sentences of subsection (a), the filing of a proof of claim or request for payment (or the taking of any other action) in a case under title 11 of the United States Code shall not be treated as action prohibited by such second sentence.

(g) Definitions.—For purposes of this section—

(1) Return.—The term "return" includes any return, statement, schedule, or list, and any amendment or supplement thereto, filed with respect to any tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44.

(2) Mathematical or clerical error.—The term "mathematical or clerical error" means —

(A) an error in addition, subtraction, multiplication, or division shown on any return,

(B) an incorrect use of any table provided by the Internal Revenue Service with respect to any return if such incorrect use is

apparent from the existence of other information on the return,

(C) an entry on a return of an item which is inconsistent with another entry of the same or another item on such return,

(D) an omission of information which is required to be supplied on the return to substantiate an entry on the return, and

(E) an entry on a return of a deduction or credit in an amount which exceeds a statutory limit imposed by subtitle A or B, or chapter 41, 42, 43, or 44, if such limit is expressed —

(i) as a specified monetary amount, or

(ii) as a percentage, ratio, or fraction, and if the items entering into the application of such limit appear on such return.

(h) Cross references.—

(1) For assessment as if a mathematical error on the return, in the case of erroneous claims for income tax prepayment credits, see section 6201(a)(3).

(2) For assessments without regard to restrictions imposed by this section in the case of —

(A) Recovery of foreign income taxes, see section 905(c).

(B) Recovery of foreign estate tax, see section 2016.

(3) For provisions relating to application of this subchapter in the case of certain partnership items, etc., see section 6230(a).

APPENDIX Z

26 U.S.C. §7441

26 U.S.C. §7441. Status [Of Tax Court]

There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court. The members of the Tax Court shall be the chief judge and the judges of the Tax Court.

APPENDIX AA

26 U.S.C. §7442

26 U.S.C. §7442. Jurisdiction [Of Tax Court]

The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title, by chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926.